

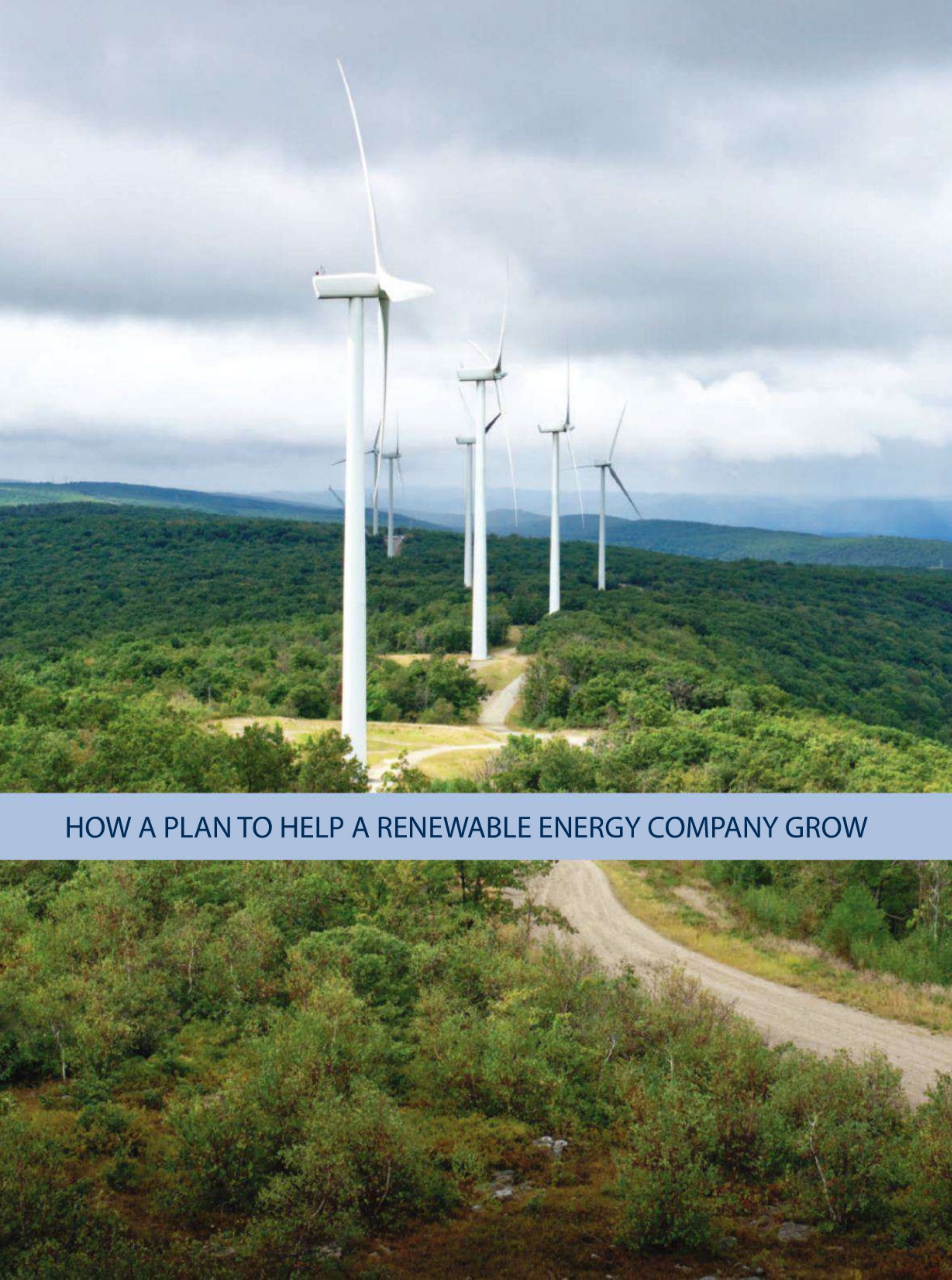
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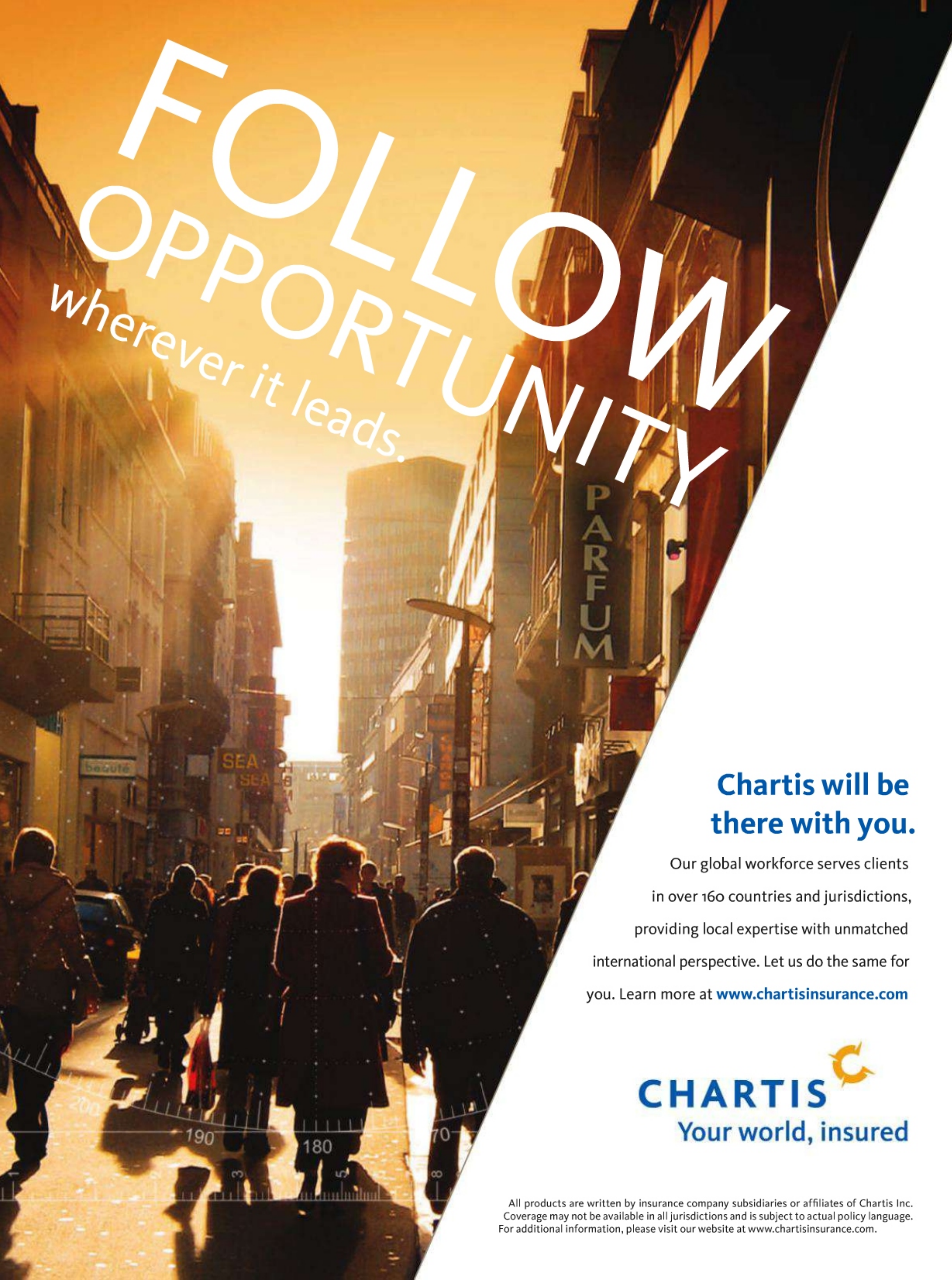

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How to Contact Bloomberg Businessweek

Editorial 212-617-6231 **Sales** 212-617-2900 **Circulation** 800-635-1200
Address 731 Lexington Ave., New York, NY 10022
Email bwreader@bloomberg.net **Fax** 212-617-9065
Customer Service PO Box 8418, Red Oak, IA 51591-1418
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In Tunisia, social networks had a role in the fall of Zine al-Abidine Ben Ali



The Fallacy of Facebook Diplomacy

Why "21st Century Statecraft"—the idea that America can use the Internet to influence global events—is more dream than reality. By Brendan Greeley

Mediocre ideas survive longest in government. In business, at least, competition tends to cull the lame and the halt. But in the public sector, theories, particularly when enlivened by events, can linger for decades. All of which explains why, now that Tunisia's dictator has left his country and Egypt's is weighing his options, we may be stuck for a good long while with what the State Dept. calls "21st Century Statecraft."

In January 2010, Secretary of State Hillary Clinton delivered an address in Washington that laid out a way to use the Internet to serve America's foreign policy goals. Protesters in Iran the summer before had gotten news out to the world using the microblogging site Twitter, and Clinton told the story of a seven-year-old girl in Haiti, freed that week from earthquake rubble with the help of a text message. "New technologies do not take sides in the struggle for freedom and progress," she said, "but the United States does."

America would take sides by building tools to route around censorship. A country that would deprive its citizens of information, the Secretary of State argued, would deprive them of a market advantage. And she called on U.S. companies to act on principle, to make access to information part of America's national brand.

Clinton was right that the Internet has a profound effect on the struggle for democracy, and there is a great deal of valuable local work being done online. But the Web is not a uniformly positive force. The dissident who organizes on Facebook, for example, leaves behind a map for security forces to follow. The real question at the heart of 21st Century Statecraft is this: Is America remotely capable of using the Internet to direct events in its favor?

Activists in Tunisia organized on Facebook, and the country's now-deposed dictator, Zine al-Abidine Ben Ali, saw the site as a threat; Al Jazeera has published evidence that the government had been using its domestic control of the Internet to pocket its citizens' Facebook passwords. Last year, however, Sami Ben Gharbia, a Tunisian blogger and activist, questioned the support, through travel and training, that American foundations and companies had begun offering to local activists. He called it "the kiss of death" and wrote that it would erode local relevance and legitimacy, and would replace domestic

FROM LEFT: CAPUCINE BAILLY/REDUX; HORACIO VILLALOBOS/EPA/CORBIS

ties among groups with bridges abroad. He worried that America would favor activists in sexy countries such as China and Iran. And he predicted something that today, watching the Obama Administration's daily hedge on Egypt, seems obvious: "This Internet freedom policy won't be applied in a vacuum," he wrote. "It will continue projecting the same Western priorities." America's instinctive support for the right to speak and assemble can be hard to square with its need for stability. That's as true online as it is in the street.

This is difficult for Americans to hear. We like to make the world a better place, to mold it in our image. (As the British author Graham Greene pointed out more than a half-century ago in *The Quiet American*, this makes Americans abroad both charming and enraging.) Now, Tunisia has a transitional government and Egypt has a teetering one, owing to upheavals aided by Facebook and Twitter. This is a victory for American ideas and American entrepreneurs. It is a victory for the resilient network America designed. But it is not necessarily a victory for the American government.

There's no telling whether successor regimes will be to Washington's liking. Nor can it be said that all American companies are on the right side of the barricades. According to a 2009 study by Harvard University's Berkman Center, the technology for Tunisia's network filtering—that is, its censorship—was provided by Secure Computing, a U.S. company that has since been acquired by McAfee (which is now to be purchased by Intel). This is not unusual; many governments in the Middle East use American tools to filter. An American company makes Egypt's tear gas, so it seems unfair to single out Secure Computing for undemocratic behavior. But it certainly makes Clinton's job more complicated.

Facebook hasn't completely adhered to the Secretary's national branding guidelines, either. Jillian York, an Internet freedom researcher at Berkman, tells the story of one of Egypt's more popular Facebook protest groups, We Are All Khaled Said, named for a young Egyptian allegedly killed by police in Alexandria last year. Before parliamentary elections in December, Facebook disabled the group. When asked to explain its decision, the company pointed out that the group's administrators were using pseudonyms, which can keep an activist safe but violates Facebook's terms of service. Facebook restored the group when a new administrator volunteered a real name. The same thing happened to a group that supported Mohamed ElBaradei, the opposition leader. York has similar stories from Hong Kong, Tunisia, Syria, and Morocco.

The problem is not that Facebook bows to autocrats, but that it's not staffed up to fulfill its new accidental mission. People in crisis don't find new platforms; they reach out on the ones they have, the ones they already use to share pictures of babies and picnics. Facebook was designed for the pursuit of happiness; it's not vital despite its frivolity but because of it. Its decisions on so-called takedowns (removing a group or an account) follow an opaque process, with no consistent way to appeal for redress. The company often lacks even the language skills to make moral and political judgments in other countries. Nor does it offer basic constitutional protections such as habeas corpus or the right to face your accuser. Brett Solomon, the executive director of Access, a nonprofit that focuses on Internet freedom, suggests Facebook provide a "concierge service" for activists, a single point of access to help resolve tricky takedown issues. Google's YouTube, according to several activists, is already exemplary in this regard.

To its credit, Facebook has begun offering an encryption method called "https" to users in Tunisia and now Sudan. Gmail offers this, too, worldwide; Yahoo! has dragged its feet. This is a classic problem in diplomacy, as old as the East India Company: States and businesses have different goals. It has never been easy to compel a CEO to spend money in pursuit of state policy, and 21st Century Statecraft hasn't made any of it easier.



The Internet is American in origin and spirit. It helped, a little, until Hosni Mubarak turned it off

As Indira Lakshmanan of Bloomberg News reported on Jan. 27, it's hard to tell whether Clinton's Internet policy is working, because to work it must happen in secret. The State Dept. says diplomats are pressing for free speech behind closed doors, but it's hard to prove this is making a difference. Such is the unfortunate nature of diplomacy. On one point, however, Clinton was demonstrably wrong: Censorship can be very, very good for business.

Last year the China social media team at Ogilvy & Mather, the advertising firm, created a graphic that compared social media services in the U.S. and China. There was little overlap. One could argue that different cultures ask different things of their social media, but Facebook has seen success in Indonesia and Brazil; it is growing in South Korea. Japan has taken to Twitter. It's far more likely that China's blocks on Twitter, Facebook, and Blogger (and its restrictions on Google) have acted as a kind of import tariff, creating space for domestic companies to thrive. As Bloomberg has also reported, the CEO of Baidu, China's premier search engine, sees commercial value in social media. Baidu has expanded since Google's departure. Clinton might do better taking her concerns about Internet freedom to the World Trade Organization.

It has been stirring to watch ever more Egyptians pour into Tahrir Square. And it's genuinely inspiring to think that the Internet helped a little, right up until Hosni Mubarak turned it off. The Internet is American in origin and spirit; it is one of the best expressions of what the nation's economy—and, yes, its government—can accomplish. But events in other countries, online or off, are largely beyond U.S. control. Evgeny Morozov, a Belarussian academic, had the bad timing to publish a book this month on the futility of Web-based protest. In *The Net Delusion: The Dark Side of Internet Freedom*, he lays out America's obsession with Radio Free Europe and *samizdat*—information that, we would like to believe, led to revolution. This dream, like 21st Century Statecraft, springs from the fond belief that Americans can be the authors of world history. As revolution spreads, it's worth remembering that even if we're reading about it on Facebook, we're still just reading.

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Dreams of an iPad Economy for Russia



Medvedev wants to lessen Russia's dependence on oil and gas

SIMON DAWSON/BLOOMBERG

▶ Corruption, little innovation, and a slow-moving state sector challenge Russia's President

▶ "Before Russia can talk about electronics, it needs to improve the power system and the roads"

Transparency has not been a hallmark of Russian government. Exhibit A: No one has quite figured out the relationship between Russian President Dmitry Medvedev and his mentor, predecessor and Prime Minister Vladimir Putin. Yet in at least one regard, Medvedev is consistently forthcoming: Russia, he says, is steeped in corruption, and it will take a long time to rectify the problem.

The nation is the world's most corrupt major economy, according to Transparency International's 2010 Corruption Perceptions Index. "Corruption has penetrated all echelons of Russian power," says Medvedev, "and it has spread far and wide after the emergence of a market economy."

The President also says he wants Russian entrepreneurs to develop and produce products as transformational, memorable, and profitable as Apple's great icons, the iPad and iPhone.

"We need to think about developing the consumer market as a whole by creating good new products," he says. He does not want to return to Soviet practices, which focused on huge industrial projects at the expense of the consumer.

Medvedev, 45, one of Russia's first iPad owners, surfs the Net regularly and has an active Twitter account. His modernization plan envisions a shift from exporting mostly natural resources to excelling in high technology. Russia's exports of gas, oil, and other energy products made up more than 70 percent of total exports in the first 11 months of last year, according to Russian customs officials.

Medvedev wants technologies to make it to consumer shelves with "Made in Russia" written all over them. "This will be the kind of modernization we seek," he says. "I would like us to create Russian iPads and Russian iPhones. True, I haven't seen anything that works yet, but it doesn't mean that we shouldn't invent. We should try and create our own models." In September, Russian industrialist Sergei Chemezov showed Medvedev a prototype of a Russian mobile phone. It will initially be assembled in Taiwan for sale later this year.

The President's push for diversification is getting some help from nonenergy companies, as Russia's economy rebounds from a record contraction in 2009 and consumer demand revives. Shares of **X5 Retail Group**, the country's largest grocer, have climbed 546 percent in the past two years, while those of **Pharmstandard**, the largest drugmaker, have risen 326 percent.

Medvedev has identified five areas where Russia could and

should make breakthroughs: information technology, nuclear energy, pharmaceuticals, aerospace, and energy efficiency. The government is investing hundreds of billions of rubles in these programs, according to Medvedev's economy aide Arkady Dvorkovich. Medvedev wants private domestic companies to catch up with foreign rivals and has been on a charm offensive to lure multinationals to help.

The Russian President last May hosted a group of U.S. venture fund chiefs, including Drew J. Guff, a cofounder of **Siguler Guff** in New York, and David Kronfeld, founder and chairman of **JK&B Capital** in Chicago. In June he visited California's Silicon Valley, where he got commitments from U.S. companies to invest in innovation in Russia, including $1 billion over a decade from **Cisco Systems**.

Siemens, **Nokia**, and **Boeing** last year agreed to join in Medvedev's pet project of developing Russia's Silicon Valley, a tech hub in Skolkovo outside Moscow. Skolkovo will offer generous tax breaks and other incentives to companies nurturing innovation there.

At the same time, Medvedev has lambasted state-controlled companies, including airline Aeroflot and oil company Rosneft, for being slow to innovate. Economy Minister Elvira Nabiullina says that 22 of the top state-controlled companies last year registered only 1,000 patents combined, compared with 5,000 patents registered by IBM. "There is money to invest. But practically no innovation," Medvedev said at a government meeting on modernization on Jan. 31. Medvedev on the same day ordered the chief of Russia's United Aircraft to be replaced.

As big Russian companies trail in innovation, small companies find it hard even to survive. "When I say that it costs me $35 to open a company here, no one in Russia believes me," Olga Potapova, a Silicon Valley entrepreneur, told Medvedev during his June visit to California. In Russia "small business does not have the capability of big business. Mr. Vekselberg can afford a group of lawyers. I can't."

Last March Medvedev appointed Viktor Vekselberg, an oil and metals tycoon who, according to *Forbes* magazine, is worth $6.4 billion, to head the Skolkovo tech hub. Once it is up and running, sometime in 2014, Medvedev wants to replicate the model across Russia.

Quoted

"For the first time in three years, I'm starting to see the light at the end of the tunnel for our country."
—Francisco González, chairman of Banco Bilbao Vizcaya Argentaria, as leaders in Spain reaffirmed plans to get the deficit down to 6 percent of GDP this year



Peter N. Loukianoff, co-founder and managing partner of Almaz Capital Partners, a Cisco-supported fund with $75 million invested in Russia-related projects, says that in general the U.S. venture capitalists who came last year to Moscow are looking more favorably on Russia. Of 20 venture capitalists who visited Moscow, at least three plan to set up biotech, clean tech, and nanotechnology funds in Russia. Andrew Somers, head of the American Chamber of Commerce in Moscow, which counts more than 700 members, says many foreign investors in Davos have reacted positively to Medvedev's modernization appeal. "I think that he is pretty successful in selling the determination of the government to stress innovation."

At the World Economic Forum at Davos, the varying views of Russia were evident. Indra K. Nooyi, chief executive officer of **PepsiCo**, which entered the Russian market decades ago, praised the country's efforts. PepsiCo in December agreed to buy a controlling stake in **Wimm-Bill-Dann Dairy and Juice**, a top Russian producer of juice and dairy products, for $3.8 billion.

Also at Davos, high-tech entrepreneur and commentator Esther Dyson spoke up about Skolkovo. "What's missing is transparency around all the contracts that are being made with Russian and American companies" in the project, she said. "I would like to suggest that in Skolkovo you add transparency. If it's proper for people to make money it should be visible how they make money."

Investors are also divided over the implications of the Mikhail B. Khodorkovsky case. In 2005 the nation's then-richest man was sentenced to eight years in prison for tax evasion. He has just been sentenced to six more on fresh charges, leading some foreign investors to view this as an episode of selective justice that damages the business climate. Says Medvedev, "I think foreign investors should not worry about just one case. When we talk about a prominent businessman, it's easier for him to inspire a wave of public reaction. He has the money." Medvedev also points out that 2,000 high-ranking state officials were sentenced on charges of corruption and bribery—proof of Russia's determination to stamp out white-collar crime.

Some big companies just find Russia hard to deal with. **Wal-Mart Stores**, the world's largest retailer, said in December it would close its Moscow office after it could not buy a local discount retailer. In 2009, **Ikea**, the home-furnishings retailer, suspended its investment plans in Russia after disputes with authorities over repeated problems in opening two new stores.

Above all, companies want a Russia that functions. As Christopher Weafer, chief strategist with Moscow-based bank UralSib Financial puts it, "Before Russia can talk about high-end electronics, it needs to improve the power supply and the roads. That's the reality that investors are more focused on."
—Lyubov Pronina, with Ryan Chilcote

The bottom line *Medvedev is on a charm offensive, trying to persuade Western companies to invest in Russia despite its problems with corruption.*

Commodities

All Fired Up Over Coal Exports to Asia

▶ Green groups are challenging plans for a West Coast export terminal

▶ "For these companies, it's a tremendous growth opportunity"

Even as the U.S. attempts to shift away from carbon-belching, coal-fired power plants, coal producers in the U.S. are gearing up to ship more of the fuel to China—which could boost their sales by hundreds of millions of dollars



Dancing with the stars at Davos page 19 ▶

annually. Green groups, though, say exports of the "dirty" fuel will worsen global warming and are mobilizing to block shipments. "How are we going to get to the climate goals that scientists have said are necessary?" asks Jan Hasselman, an attorney with Earthjustice. "These decisions are being made by others, such as the coal companies, by default."

Opposition from environmentalists has coalesced around a proposal from Australia's **Ambre Energy** to build an export terminal on the Columbia River in Longview, Wash., where more than 5 million tons of coal a year would be loaded onto ships. The Sierra Club and three other groups have challenged the project.

Washington State's Cowlitz County on Nov. 23 granted a shoreline development permit for Ambre to convert an out-of-commission aluminum smelter into an export terminal. The environmental groups have appealed the decision, citing the health hazards of coal dust and the increase in pollution that will result from burning the fuel abroad. In their petition for review they claim that the 5.7 million tons per year of coal exported by the facility will generate more than 11 million tons of carbon dioxide annually—roughly equivalent to the emissions of two million U.S. cars. A hearing on the matter is scheduled for Apr. 11.

Millennium Bulk Terminals, the Ambre Energy subsidiary spearheading the project, did not return calls. In a Jan. 13 statement, MBT Chief Executive Officer Joe Cannon said, "We will clean up and revitalize this property and ensure that it will have a very positive economic impact in the local area."

Insufficient port capacity has hampered efforts to boost shipments of low-sulfur coal from the Powder River Basin in Wyoming and Montana—an area that accounts for some 40 percent of all U.S. coal production—to Asian markets. Japan, China, South Korea, and India are the world's top importers of coal, according to data compiled by the World Coal Assn. Yet less than 7 percent of U.S. coal is shipped from Pacific ports, U.S. Energy Information Administration figures show.

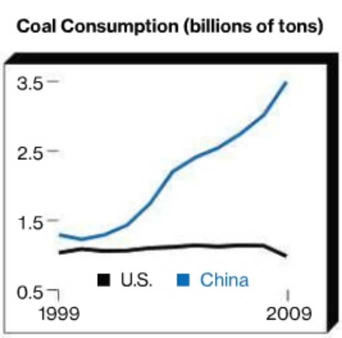
Boosting overseas shipments is a priority for the U.S. coal industry, which could soon face shrinking demand at home as a result of efforts to regulate carbon. West Coast shipments may increase by 50 million tons a year if more port facilities are built, according to Jeremy Sussman, an analyst at New York brokerage Brean Murray, Carret. At current prices of $13.75 a ton, that would add $688 million to the annual revenue of companies mining coal in Western states, such as **Arch Coal, Cloud Peak Energy,** and **Peabody Energy**."For these companies it's a tremendous growth opportunity," says Kevin Book, managing director of ClearView Energy Partners, a policy analysis firm in Washington, D.C.

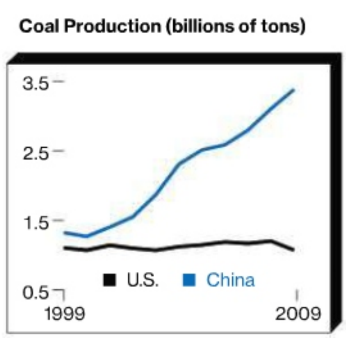
Environmentalists are seeking to turn the Ambre Energy development into a test case, in hopes of bringing a halt to other projects on the drawing board. Peabody, the No. 1 ➡

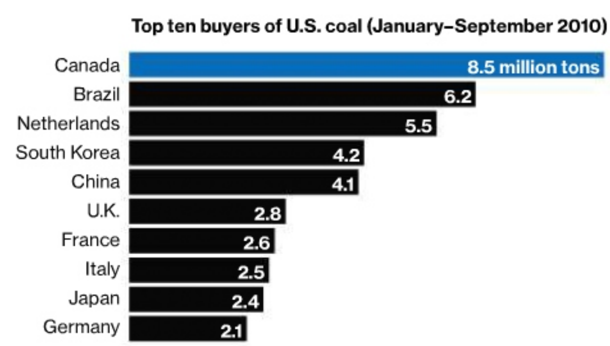
Remapping the Coal Trade

A lack of port capacity on the West Coast has hampered U.S. coal exports to Asia, where demand is growing the fastest. Proposed terminals, such as one in Longview, Wash., are drawing opposition from environmental groups.









DATA: U.S. ENERGY INFORMATION ADMINISTRATION

FROM LEFT: PAUL WHITE/AP PHOTO; ANDREW HARRER/BLOOMBERG

Global Economics

coal producer in the U.S., has said it will release plans for its own West Coast port by the end of this quarter. “What’s missing is a coherent federal policy that looks at the bigger picture,” says Hasselman of Earthjustice, which is representing the other environmental groups in the case. “There is a role for the Environmental Protection Agency to come in and help with some of the questions here.” EPA spokeswoman Alicia Johnson said the agency is reviewing issues related to the Ambre Energy proposal.

Fredrick D. Palmer, senior vice-president for government relations at Peabody in St. Louis says a policy of restraining U.S. exports that contribute to global warming would affect a wide range of industries beyond coal. “Anything we make in the U.S. requires energy and creates carbon dioxide,” says Palmer. “This is a deindustrialization philosophy applied to coal first, and it won’t stand.”

—*Jim Efstathiou Jr.*

The bottom line *U.S. environmentalists seek to turn an Australian company’s coal export terminal into a test case for slowing the global coal trade.*

Education

The SAT Is to America As ____ Is to China

▶ **A new push to offer U.S. college-entrance exams to Chinese pupils**

▶ **“There’s this real sense of a huge, untapped market”**

As a high school student in Beijing, Xi Zhao cleared a hurdle applying to U.S. colleges that Americans don’t face. The SAT college-entrance exam isn’t offered in mainland China, so Zhao flew to Hong Kong and South Korea to take it twice. She earned the maximum 800 in math and 2080 out of 2400 overall—a score that helped her get into the University of Southern California in Los Angeles. Not being able to take the SAT on the mainland “is a hassle,” says the 20-year-old, now a junior with a 3.8 grade point average. “It’s not fair that other students can just take the test at their high schools and we have to travel for hours.”

The number of Chinese undergraduates in the U.S. has quadrupled in four years. Now, the nonprofit College Board, which owns the SAT, PSAT, and Advanced Placement programs, is seeking the education ministry’s permission to start offering the SAT on the mainland. “We’ve had serious discussions with Chinese officials,” says Board President Gaston Caperton. “They recognize it’s a big burden on parents.”

The SAT’s absence on the mainland is a relic of an era when China was less open to the West, Caperton says. As a former British colony, Hong Kong has long let students take the exam. China permits other U.S. tests such as Advanced Placement exams, which let high-schoolers earn college credits.

Chinese officials “have a very mixed feeling” about the SAT policy, says Tom Melcher, chairman of Zinch China, an online social network that matches Chinese students with U.S. colleges and scholarships. Officials “don’t want the SAT blasted on all the walls of all the high schools,” Melcher said. “It would feel politically invasive.”

In the last academic year, 39,921 Chinese undergrads studied at U.S. colleges, passing South Korea as the No. 1 source of international undergraduates, according to the Institute of International Education, a nonprofit group in New York. “All of us in higher education are hopeful that the day will come when the SAT will be available in mainland China,” says Kelly Walter, executive director of admissions at Boston University. The Education Ministry in Beijing and the embassy in Washington, D.C., did not respond to messages.

U.S. college recruiters are mining China’s best schools for well-qualified, full-paying applicants. Increasing affluence and China’s one-child policy mean middle-class Chinese can afford tuitions that far exceed the price of school at home. “There’s this real sense of a huge, untapped market,” says Timothy Brunold, dean of admissions at USC, which admitted 162 students from China in 2010, up from six in 2005.

The College Board, which had revenue of $623 million in fiscal 2009, charges $47 to take the SAT in the U.S. and $75 internationally. The Board in 2006 introduced an Advanced Placement course in Chinese language and culture, and has brought more than 450 instructors

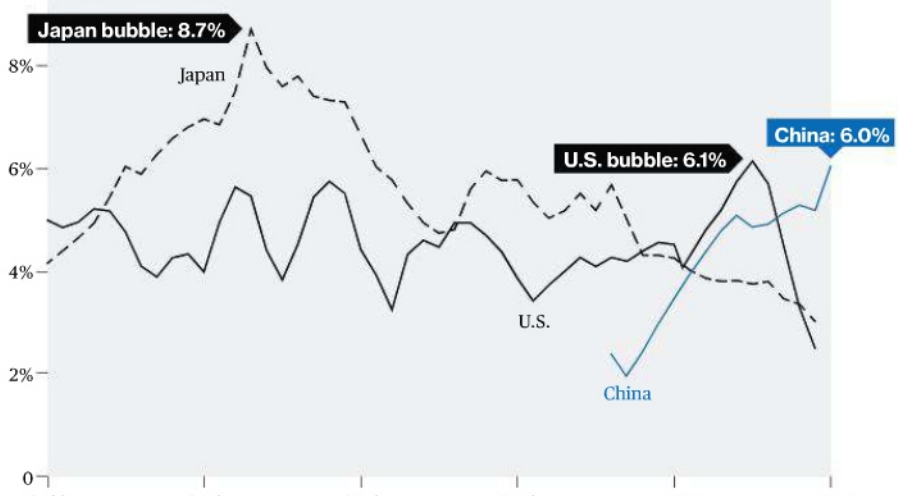
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Housing Market

First the Boom, Then...

China’s property market may be poised for a steep downturn as the economy’s reliance on real estate reaches a level close to the housing peaks witnessed in the U.S. and Japan, according to research by Citigroup.

Residential housing investment as a share of GDP



DATA: BLOOMBERG

ANDREW HARRER/BLOOMBERG



Tom Keene's EconoChat

Tom talks with **Tom Porcelli,** U.S. market economist at RBC Capital Markets, about Egypt, inflation, and the rebound in U.S. consumer spending

Do you care about Egypt?
We should all care about Egypt. We went back and looked at the last time an event like this happened in the Middle East. We determined that Iran back in 2009 had some similar events, and what we saw then among investors was a massive flight to quality. Over that time, 10-year [Treasury] yields rallied about 40 basis points, so I think something like that is certainly something we should be braced for.

Tell us about retail sales booming as jobs struggle.
We are looking at around 3 percent growth in consumer spending over the course of a year. That might sound O.K., but the truth is, we should be significantly higher than this given the recession that we just came out of. We are growing at half the pace relative to other severe, post-recession recoveries.

Why is that?
If you look at the distribution of jobs, growth has really been concentrated in just three categories. Together they account for 75 percent of all job gains. It's professional, medical, and–shockingly–manufacturing.

What about inflation?
I think we are probably going to have slightly more inflation than the market now presently thinks. The consensus outlook is around 1 percent to 1.5 percent for core inflation by the end of the year. We think it is going to be closer to 2.2 percent. B



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

Global Economics

from China to teach it in the U.S.

Next year, Chinese schools will offer the PSAT, which identifies academic strengths and weaknesses in younger students. Says Xiang Wang, who in 2009 became the College Board's first vice-president of international relations for Asia, Chinese officials are "very tantalized but very cautious" about introducing international educational programs. "This is not an easy decision."
—*Daniel Golden*

The bottom line *The College Board wants permission to offer the SAT in China, opening up a huge market for the $600 million business.*

Energy Security

The Oil Market Keeps a Close Watch on Suez

▶ Security is increased on the still-vital transit route for tankers

▶ The parallel pipeline is even more important than the canal itself

Egyptian troops have reinforced the guards protecting the Suez Canal and the Suez-Mediterranean oil pipeline running alongside it, according to an official with knowledge of the buildup. Energy consultancy IHS CERA figures that more than 1.7 millions barrels of crude pass through the canal and the "SuMed" each day. The SuMed takes oil from large tankers that cannot navigate the canal when fully loaded and delivers it to empty tankers waiting off Egypt.

An act of sabotage or a decision by a new regime to close the canal and the pipeline to punish supporters of Egyptian President Hosni Mubarak could send oil prices sharply upward. From 1967 until 1975, Egypt kept the canal closed in response to Israel's seizure of Arab territory, forcing tankers to travel around the Cape of Good Hope. Today disruption of the SuMed would have a bigger impact on the oil and shipping markets than a shutdown of the canal itself, Eri Nikolai Stavseth, an analyst at Arctic Securities in Oslo said in a report on Jan. 31. Ⓑ
—*Abdel Latif Wahba*

The bottom line *Investors worry that the flow of oil through the Suez Canal will be disrupted by the Egyptian uprising. So far the canal has stayed open.*

Events of note in the week ahead

Seven Days

by Ira Boudway

07

IPO for the Aveon Group on the NYSE



▶ **U.S. consumer credit:** Auto and student loans drove increased lending in October and November, even as credit-card debt continued to shrink. Surveyed economists expect lending to expand by $2.4 billion in December.

08

Bank of Italy lending and bad-debt data

Canada's housing starts

▶ **Walt Disney earnings:** The media company fell short of expectations in the fourth quarter when profits dropped 6.7 percent from the previous year. Analysts anticipate $10.5 billion in sales for the first quarter.



09

Japan's Consumer Confidence index

Earnings from Allstate, MetLife, and Whole Foods



▶ **China's trade balance:** December's export surplus of $13.1 billion was the smallest since April.

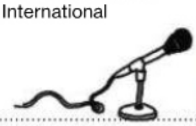
▶ **Coca-Cola earnings:** Analysts expect fourth-quarter revenue of $10.2 billion at the world's largest soft-drink maker.

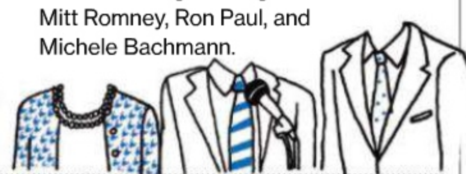
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New York Fall Fashion Week begins

Earnings from Chipotle, Kraft, PepsiCo, and Philip Morris International

▶ **CPAC 2011:** Speakers at the annual conservative gathering include Mitt Romney, Ron Paul, and Michele Bachmann.



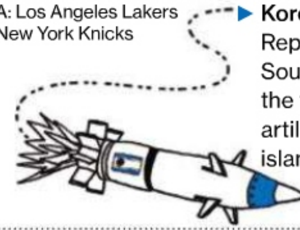


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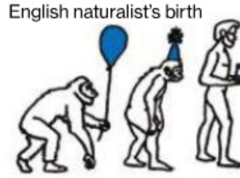
NBA: Los Angeles Lakers vs. New York Knicks

▶ **Korean military talks:** Representatives from the North and South are scheduled to meet for the first time since the North fired artillery shells onto a South Korean island in November.



12

Darwin Day: Universities and museums mark the English naturalist's birth



▶ **Manchester Derby:** English soccer's Manchester United and Manchester City, both contenders for the Premier League title, meet at Old Trafford stadium.

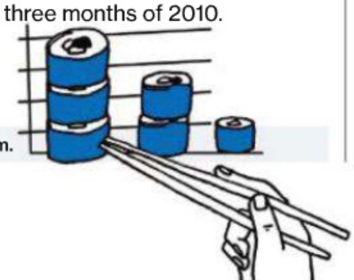


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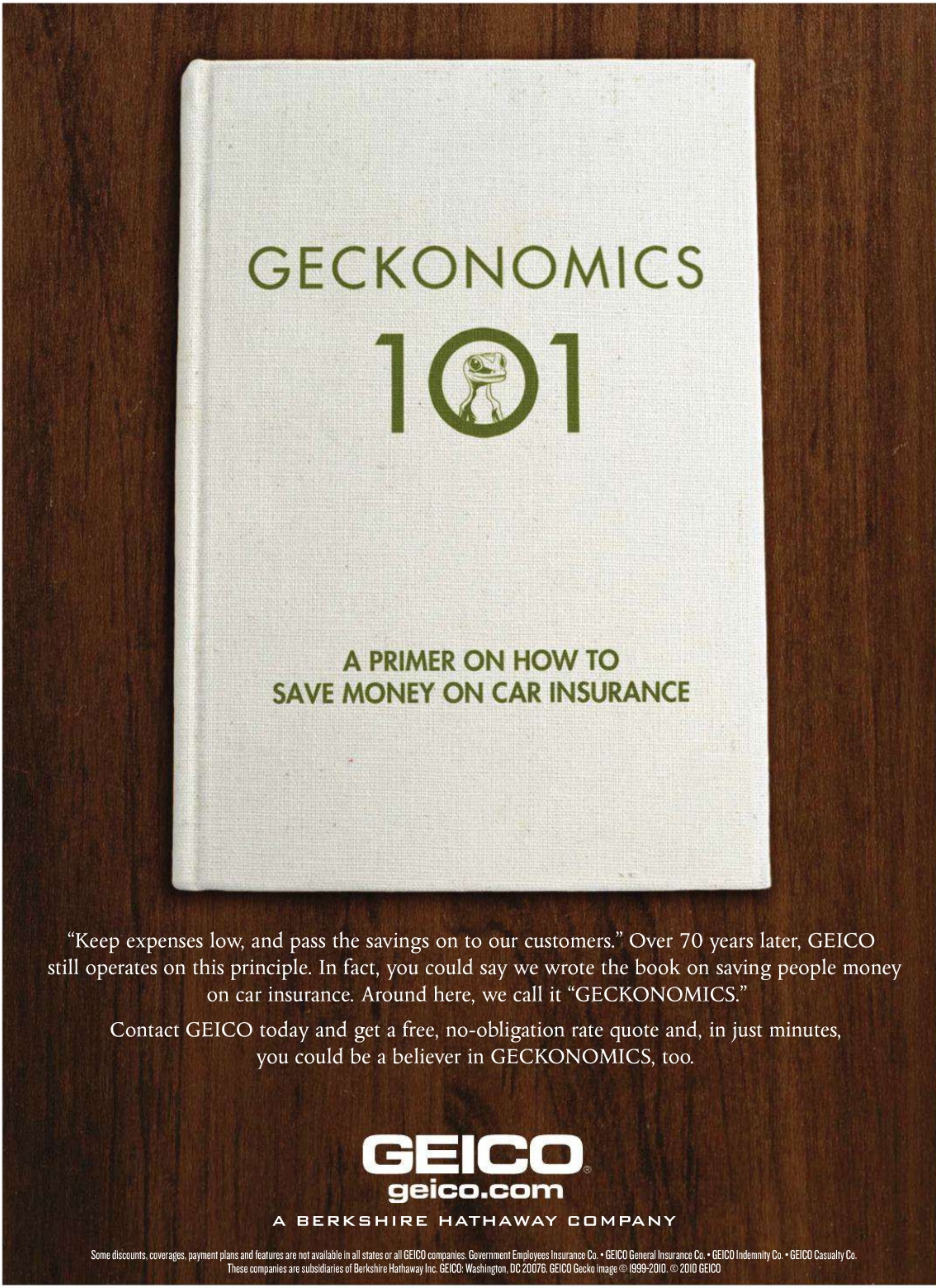
The Grammy Awards in Los Angeles

▶ **Japan's fourth-quarter GDP:** Surveyed economists anticipate that the world's third-biggest economy contracted slightly in the last three months of 2010.



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ILLUSTRATIONS BY JULIA ROTHMAN


GECKONOMICS
101
A PRIMER ON HOW TO
SAVE MONEY ON CAR INSURANCE
"Keep expenses low, and pass the savings on to our customers." Over 70 years later, GEICO still operates on this principle. In fact, you could say we wrote the book on saving people money on car insurance. Around here, we call it "GECKONOMICS."
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That's why we're building them today, with customers all over the world.

It's why we're designing our technology to last longer and use fewer resources. It's why we're helping our customers reduce their CO_2 emissions. And it's why we're pioneering new answers with one of the world's largest environmental portfolios.

As a result, we were just named the best in our business sector by the Dow Jones Sustainability Index. And recognized as the top company overall by the Carbon Disclosure Project, the world's largest independent database of corporate climate change information.

Yet we'd never claim to have all the answers. That's why we're working with 190 countries. Thousands of cities. Tens of thousands of companies. In energy, industry and healthcare.

We're working with the world today to create answers that last for the world of tomorrow.

siemens.com/answers

Contents ▶ Economists choose sides on spending cuts: David Cameron's ax or Obama's go-slow strategy? 20
▶ At Davos, some VIPs are more important than others. You can tell by the badge 22 ● Edited by Chris Power

Focus On Davos

Snipers on the rooftops










Swiss fanfare






The Belvédère hotel

Bono and Bankers Play Their Roles for the Elite

▶ Bankers and Presidents bicker over regulation while optimism creeps back

▶ "The best way to say thank you is to start lending," said Lagarde to Barclays's Diamond

"The mood of Davos is always a counter-indicator," says Harvard University historian Niall Ferguson. "It's a consensus not to be believed in. The more complacency there is, the more I'm worried."

So what did we glean during five days at the World Economic Forum's annual meeting in Davos? Well, everyone agrees that China and India are Really Important, though no one seems to have a clue whether to rejoice or despair as economic power shifts. Investment bankers would like us to pretend the credit crunch never happened so they can go back to bonus as usual. And for those people clever enough to look past the middle of next week, anxiety over the outlook for food and water security is enough to cause some sleepless nights.

Frankly, though, we knew all of that before the threat of global warming was exacerbated by transporting thousands of executives and associated gawkers to Davos. (Although we did learn that when you trap the great and the good in a small Swiss ski town, the taxi drivers—almost invariably driving Audis—can charge $2 per minute and more to get you from an undernourishing conference center to your overpriced restaurant or accommodation.)

More compelling were the flashes of heat revealing the tensions that lurked beneath the surface. An attempt led by **JPMorgan Chase** Chief Executive Officer Jamie Dimon and **Barclays** chief Robert E. Diamond Jr. to lower the curtain on the financial crisis backfired. Dimon's warning about the risk of "bad policies" prompted a lecture on "moral values" from French President Nicolas Sarkozy. And when Diamond expressed "very heartfelt thanks" for government bailouts of his industry, French Finance Minister Christine Lagarde retorted that "the best way to say thank you is to start lending, keep compensation reasonable, and improve your capital levels." (The previous day, **Goldman Sachs** announced a $12.6 million stock bonus for CEO Lloyd C. Blankfein for 2010, and raised


Jamie Dimon
Christine Lagarde
Nicolas Sarkozy

SWISS-IMAGE (9); BLOOMBERG (5)



Not your mother's Tupperware party ◀page 30

his base salary to $2 million this year, from $600,000.) "There is a high level of public anger," says Robert J. Shiller, an economics professor at Yale University. "There's a sense the good guys are coming last."

Though regulators and bankers clashed, the mood music emanating from the private lunches and off-the-record briefings left the impression that Europe's sovereign debt crisis is reaching its endgame. Spain and Greece are earning plaudits for belatedly tackling their swollen deficits. That's giving German politicians the ammunition they need to hustle a bond-backed bailout past their taxpayers. As evidence of the newfound optimism that default can be averted, the spread between the rate investors demand to lend to Greece and what they'll accept from Germany has narrowed to a three-month low.

The corners and coffee bars of the conference center illustrated how the mobile technology wars were panning out. Anecdotally, at least, **Apple**'s iPad has obliterated the laptop among note takers and Web surfers, while the iPhone is the favored confidante of the chattering classes. **Research in Motion**'s BlackBerry, though, is still the e-mail device of choice. "The iPad is the gizmo of the year," says Joe Saddi, chairman of global consulting firm **Booz & Co.** "I have a BlackBerry, iPhone, and iPad. They all have different uses." Jim Balsillie, RIM's co-CEO, displayed his BlackBerry PlayBook tablet prototype slated for release later in the year. He kept mum, however, on his battle plan for engaging with Apple.

A personal highlight was listening to Bono of U2 and Peter Gabriel debating with Daniel Ek, co-founder of the **Spotify** music service, about whether musicians will ever get paid a fair price for digital distribution of their songs. Trekking halfway up a mountain to get to a party was made worthwhile after we persuaded Bono to serenade us with an up-close-and-personal rendition of *Two Shots of Happy, One Shot of Sad*, a song he co-wrote with U2 guitarist The Edge, hoping that Frank Sinatra would record it—and one that seems to sum up Davos quite well. —*Mark Gilbert with Simon Kennedy*

The bottom line *While tension between regulators and bankers occasionally surfaced, the mood at Davos was more optimistic than in recent years.*

20

Austerity

Cut Like Cameron Or Hedge Like Obama?

▶ **Discord at Davos over the best way to time government spending cuts**

▶ **"If Japan can get downgraded, why not the U.S.?"**

High in the Swiss Alps, executives and economists lined up to warn President Barack Obama that he must be more ambitious in cutting a fiscal shortfall the Congressional Budget Office now estimates will reach $1.5 trillion this year. By contrast, British Prime Minister David Cameron was pushed by delegates including billionaire George Soros to rethink Britain's tightest fiscal squeeze since World War II before it triggers another recession. "The timing of austerity was the one theme at Davos where there was a lot of disagreement," says Nariman Behravesh, chief economist at consultancy IHS Global Insight.

No policymaker likes the options: Go too fast in paring spending or raising taxes, and a government risks snuffing out an expansion that has only just begun and is still not powerful enough to propel hiring. Act too slowly, and investors may start imposing higher interest rates, hurting growth in another way. "You've got to strike the right balance, and it's not going to be easy," says Canadian Finance Minister James M. Flaherty.

The fiscal debate is moving to center stage just as the International Monetary Fund has upgraded its forecast for global growth to 4.4 percent this year, from its earlier estimate of 4.2 percent. As the outlook has improved, some economists at Davos argued that Obama's fresh budget savings of almost $500 billion, revealed in his State of the Union address, were too meager. They said that after signing an $858 billion tax cut, Obama had to take advantage of the rebound and cut spending further. "Unless the U.S. addresses this fiscal problem, we're going to have a train wreck," says Nouriel Roubini, chairman of Roubini Global Economics. James S. Turley, chief executive officer of Ernst & Young, says "we need a heck of a lot more action" in the U.S.

Cameron's strategy didn't fare much better at Davos. Soros says Cameron's austerity budget cannot "possibly be implemented without pushing the economy into a recession." (The British economy shrank unexpectedly by 0.5 percent in the final quarter of 2010, even before Cameron's cuts were felt.)

Cameron used a keynote speech to restate that his "first priority is to kill off the specter of massive sovereign debts." After exchanging places with him on the stage, U.S. Treasury Secretary Timothy F. Geithner said U.S. growth is still too weak to push unemployment down significantly. He added that while it's right to balance the budget over the longer run, quick and premature cuts aren't "responsible" and risk doing "a lot of damage to an early expansion."

Nobel Laureate Joseph Stiglitz backed the U.S. bias toward sustained stimulus and warned Cameron he "is succeeding in causing a recession" that may end up inflicting more debt on the country as tax receipts fall and welfare spending rises. Harvard's Niall Ferguson, an informal adviser to Cameron, says the "U.K. is doing the right thing, and the U.S. has made no attempt whatsoever to deal with this issue. If Japan can get downgraded, why can't the U.S.?" he asks. (Standard & Poor's recently downgraded Japanese sovereign debt.) Raghuram G. Rajan, a former IMF chief economist and a professor of finance at University of Chicago's Booth School of Business, uttered the ultimate truth: "There is no painless deficit reduction."
—*Simon Kennedy*

The bottom line *Davos exposed a rift in economists' ranks over which is better: Obama's softly-softly approach to the deficit, or Cameron's ax.*



CLOCKWISE FROM TOP: BRIAN ULRICH; TOMOHIRO OHSUMI/BLOOMBERG; SIMON DAWSON/BLOOMBERG; MORITZ HAGER/SWISS-IMAGE

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Parties

Davos 41: Platitudes, Lobster, and "Bill"

▶ The color of the badge matters above all. Clinton is still king of cool

▶ "If you have a million dollars, clap your hands!"

At one of the first sessions of Davos 2011, Nouriel Roubini, the economist famed for predicting the financial crisis, raised his water glass. The economy, he said, was like his glass: "half empty, half full."

As they have for 41 years, members of business and political royalty scaled the Swiss Alps to hear fellow wise men make similar pronouncements. The roughly 2,500 attendees listened to heads of state defend the euro in doth-protest-too-much moments, and they got in a little skiing. Davos is the rare event that can "bring billionaires to stay in three-star hotels," says Adrian Monck, managing director of the World Economic Forum. Thread counts don't matter much, since little sleeping gets done. After days filled with private meetings that have more to do with dealmaking than the WEF's professed goal of "improving the state of the world," most attendees get down to serious partying.

While Davos is a meeting of the elite, some elite are more elite than others. A rainbow of badge colors conveys status, with white badges at the top of the heap. At the tippy-top of the top of the heap are those who have multicolored plastic discs, dubbed "disco dots" by some security personnel, that fasten the white badge to its lariat. Only heads of state and über-ministers with disco dots have the privilege of using a door marked "public figures" to enter the main hall. Chief executive officers and Nobel laureates must use a door several feet away.

That level of distinction was underlined by ex-President Bill Clinton, the conference's biggest draw and its best-received. After WEF founder Klaus Schwab called him "Bill" a few times, serial White House staffer David Gergen stood to ask some questions pointedly addressed to "Mr. President." Clinton hosted one of the private parties that really do require an invite: a lunch to discuss unemployment with senior executives on a mountaintop accessible by funicular. **Goldman Sachs**'s Gary Cohn and **Bank of America**'s Brian Moynihan were among the guests.

About 220 parties and receptions were held at the Belvédère hotel during Davos 2011

The party scene resulted in some unlikely combinations. Representative Barney Frank (D-Mass.), who said he was there to talk to European financial regulators, attended Goldman's dinner on Friday evening at Restaurant Bündnerstübli. At a **Coca-Cola** soiree with a vague sustainability theme, U.S. Treasury Secretary Timothy Geithner chatted with Yale law professor Amy Chua, aka the Tiger Mother. A contingent from **Facebook**, including Chief Operating Officer Sheryl Sandberg, attended. And President Clinton, the guest of honor, praised the good works of Coke CEO Muhtar Kent. Too late to catch his remarks was Britain's Prince Andrew, who arrived desperately in search of the "loo."

McKinsey's bash was at the Belvédère hotel, which had a sniper on its roof. **Hewlett-Packard** CEO Léo Apotheker elbowed his way ahead of others at the coat check on his way in. Tall consultants overflowed the dance floor, raising the question of whether consultants should be allowed to dance at all. "If you have a million dollars, clap your hands!" shouted one member of the house band. Roubini was seen fleeing the scene.

Google's party, thrown the next night in the same space, was, not surprisingly, a bit cooler. There was a lot of black clothing (though Eric Schmidt sported a salmon-colored sweater), and everyone looked like they'd received the proper Swiss permits to dance to music provided by two U.K.-based DJs. The last guests were ushered out at 4 a.m. The final night's gala was a mostly white-badge affair, with cuisine whipped up by a chef flown in from New Delhi's five-star ITC Maurya hotel.

Davos occurs in a bubble of sorts, and it takes a while for news to seep in. By the time the forum added a panel on Tunisia, Cairo was erupting. Egypt was discussed in a plenary session on Saturday. The moderator asked audience members to "speak up" if they saw fresh news on their iPhones. Kishore Mahbubani, dean of Singapore's Lee Kuan Yew School of Public Policy and former president of the U.N. Security Council, announced that "something profound has happened," and several panelists referred to Egyptian public sentiment as coming from "the street." On the forum's final day there were plenty of other distractions: It was a great day for skiing, and there were piles of Norwegian lobster to lunch on.

—Ellen Pollock, with Serena Saitto and Robert Friedman

The bottom line *The world's pundits partied and pontificated at Davos yet had to scramble to gather intelligence on the turmoil in Egypt.*



Prince Andrew · Amy Chua · DJ Norman Jay

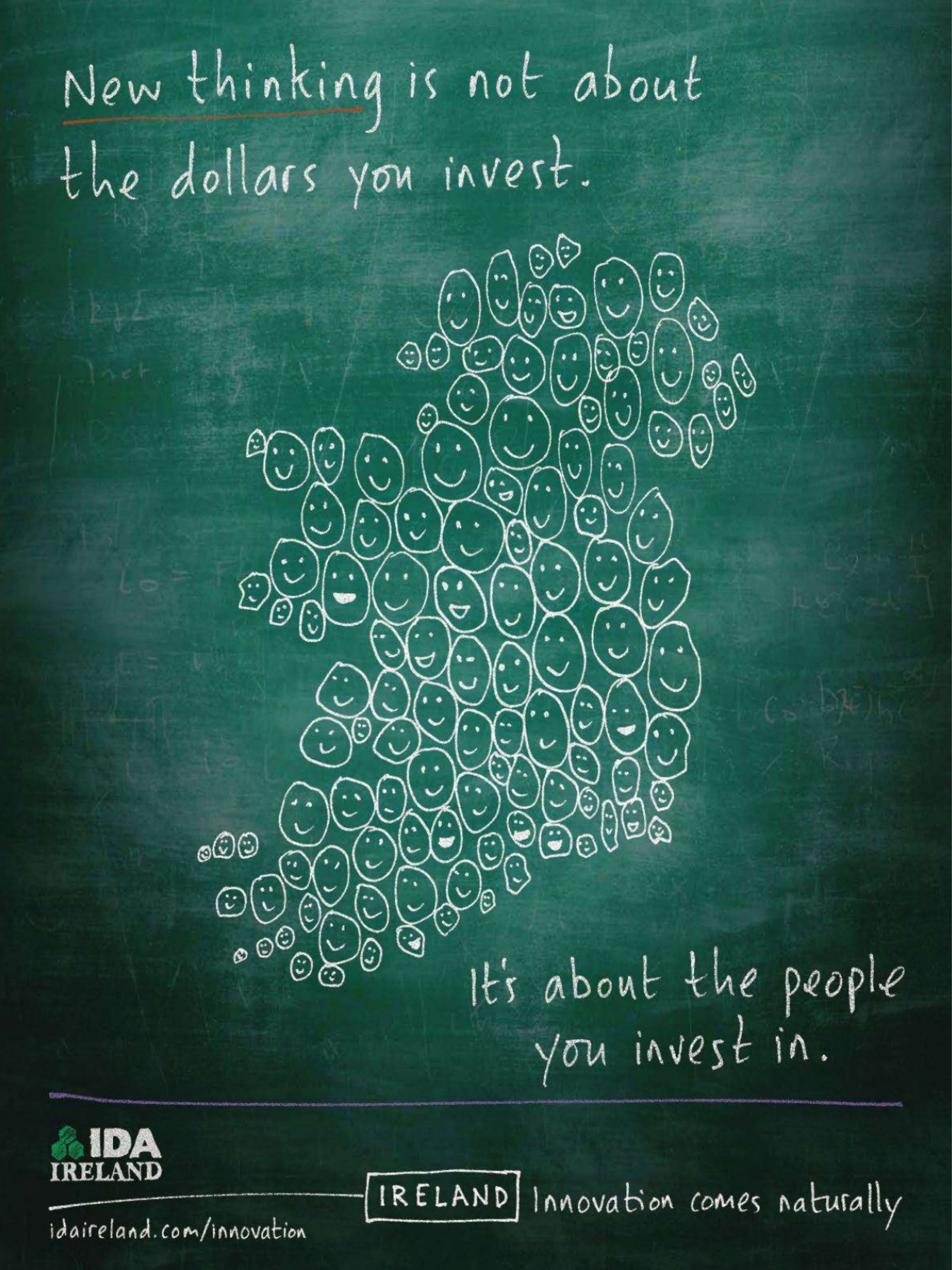
Agenda/Day2

A day in the Davos life of Imax CEO **Richard Gelfond**



8 a.m.	Edelman public relations breakfast
9-10:15 a.m.	Attend session at conference center: Insights on China
10:30 a.m.	Informal meeting with Chinese CEO
11 a.m.	Meeting with Indian real estate developer
2 p.m.	Interview with Shen Hong, China bureau chief for Dow Jones Newswires
3 p.m.	Interview with Liz Claman, Fox Business
3:15-4:30 p.m.	Attend session: Reshaping the U.S. Economy: The Impact Abroad
4:45 p.m.	Informal briefing with media executive
5:30 p.m.	Meeting with NYSE executive
6 p.m.	Reception of global accounting firm PwC
6:30 p.m.	Yale University reception
10-11:30 p.m.	Chinese media reception

FROM LEFT: CHRIS RATCLIFFE/BLOOMBERG; BEN STECHSCHULTE/REDUX; LOUISE WILSON/GETTY IMAGES; JONATHAN FICKIES/BLOOMBERG


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the dollars you invest.
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The Recession Is Gone, and The CEO Could Be Next

▶ **More boards are cleaning out the corner office, looking for different kinds of leadership**

▶ **"We're going into a 24-month cycle of CEO volatility," predicts an executive recruiter**

During a series of meetings of directors of Minneapolis-based **Medtronic** in recent weeks, board members have mulled potential successors to outgoing Chief Executive Officer William A. Hawkins. Although the 56-year-old Hawkins had been in charge for just three and a half years, he announced in late December that he would retire in April. During his tenure, the medical equipment maker's stock has dropped 30 percent amid waning growth for core products such as pacemakers. Medtronic now says it's looking outside its ranks for a new leader—a big change for a company that usually fills the top spot from within, but one that may be needed in its fast-changing industry.

"It requires that you keep taking a good look," says Medtronic director Robert C. Pozen, who lectures on corporate governance at Harvard Business School and is chairman emeritus of **MFS Investment Management**. Pozen declined to talk about Medtronic's CEO search but acknowledges that boards are under increasing pressure to maintain management performance. "You can make the right choice for CEO, [and] then if the regulatory environment or the business has shifted, he may no longer be the right person."

After three years of declining turnover among CEOs, churn at the top is back. As the economy improves, the rate of corner-office shakeups has picked up as more boards replace veteran CEOs with younger leaders with very different résumés. Many new CEOs have international experience and a track record in marketing or sales rather than finance or manufacturing, the specialties of CEOs two or three decades ago. They also haven't necessarily spent their careers at one company or in a single industry.

A case in point is **Campbell Soup** Chief Operating Officer Denise Morrison. She will become Campbell's CEO in August, after zigzagging from **Procter & Gamble** and **PepsiCo** to **Nestlé**, **Nabisco**, and **Kraft Foods** before joining the soupmaker eight years ago.

Among other changes: new **Pfizer** CEO Ian Read, who formerly was group president of its global biopharmaceutical business and earlier worked in Europe and Latin America, replaced Jeffrey B. Kindler, a lawyer with no operations or overseas experience; **Google** co-founder Larry Page, a software developer who is 38, replaced veteran executive Eric Schmidt, with the mandate to restore innovation to the Internet giant; and **Advanced Micro Devices** CEO Dirk Meyer resigned after splitting with directors over the No. 2 chipmaker's strategy.

More reshuffling is imminent. **Newell Rubbermaid** CEO Mark D. Ketchum, 61, plans to retire as soon as a successor is found. Ketchum sold off and restructured businesses during his five years at the helm of the Atlanta-based consumer-products maker. Now directors are seeking a CEO to expand the company, especially overseas. **3M** is evaluating several managers at the company to succeed CEO George Buckley, who plans to retire next year at 65.

Meanwhile, **Sony** is conducting a search for a president who would be a successor to CEO Howard Stringer, who turns 69 in February. And a succession horse race among several **IBM** executives is under way at that company. In July, CEO Samuel J. Palmisano will turn 60, the age at which IBM CEOs have typically retired.

The rush to change corporate leadership is a turnabout from the management standstill that set in during the financial crisis. CEO turnover declined from 12.7 percent in 2007 to 9.4 percent last year, according to a study of Standard & Poor's 500-stock index and Fortune 500 companies by executive search firm **Crist/Kolder Associates** in Chicago. One likely reason: Boards were reluctant to change leadership during the recession, concerned that if a CEO left, investors might think the company was coming unglued.

With the economy recovering, Crist/Kolder is predicting a return to double-digit corner-office turnover at big companies in 2011 and 2012, says Chairman Peter Crist. "We're going into a 24-month cycle of CEO volatility," he says. "Since companies are now compared to competitors on proxy statements, there's heat on boards to change leaders who aren't getting results."

New CEOs have fewer gray hairs; recruiters say executives approaching 60 are today often bypassed in favor of younger candidates. And they expect to serve shorter tenures: six to eight years, vs. 10 to 15 years a generation ago, according to a **Booz & Co.** study of CEO succession from 2000 to 2009.

Boards today also want CEOs who have run an international business, traveled extensively overseas, and have connections with executives and gov-

25%

Drop in CEO turnover at 668 major companies from 2007 to 2010

ILLUSTRATION BY GILBERT FORD & ALEX EBEN MEYER



ernment leaders around the world—experiences they need to oversee big companies that often can derive up to half, or even more, of their revenues from foreign markets. Being a director of a public company also counts in an era of heightened corporate governance when CEOs must work more closely with their boards—and often report to a nonexecutive chairman.

"CEOs of big global companies today understand that they need to respond to consumer groups and [nongovernmental organizations] and work closely with governments around the world," says Rakesh Khurana, a Harvard Business School professor who studies leadership. "They aren't going to do what former **General Electric** CEO Jack Welch did a decade ago when he tried [unsuccessfully] to gain approval to acquire **Honeywell International** and lectured the EU about economic policy. There's more modesty now."

Boards itching to change leaders often are starting from scratch. Only 35 percent of 1,318 executives surveyed by **Korn/Ferry International** in December said their companies had a succession plan. A 2010 survey of 140 North American CEOs and directors found the respondents' boards averaged only two hours a year on CEO succession. Some 39 percent of respondents to the survey, conducted by executive search firm **Heidrick & Struggles** and Stanford University's Rock Center for Corporate Governance, said their companies had no viable internal CEO candidates.

A smooth corner-office transition often depends on a CEO who has groomed subordinates to replace him or her. Four years before he turned 65, Richard T. Clark, **Merck**'s chairman and former CEO, began grooming Kenneth C. Frazier for the corner office. Frazier, a lawyer by training who was named Merck's new president and CEO in January, made his reputation defending Merck against Vioxx lawsuits. In the last three years, Clark made Frazier the company's global sales and marketing chief and then president, to build his leadership experience. Frazier also is a director of **ExxonMobil**.

Some recruiters see a limited pool of CEO candidates, especially since private equity firms have siphoned off talent from public companies'

management. Tom Tiller, for one, left snowmobile maker **Polaris Industries** in December 2009 to become CEO of **Abound Solar**, a solar module manufacturer that's raised more than $250 million from several private equity investors. Ari Bousbib, formerly president of **United Technologies**' commercial businesses and an executive considered a likely UT chief, left in September to become CEO of **IMS Health**, which provides research to pharmaceutical companies and is owned by **TPG Capital** and other investment firms.

"Ari was being chased by numerous public companies," says search executive Crist. "Every time we're doing a CEO search now, the candidate is also talking with TPG, **Blackstone,** or another private equity firm," he says. It's difficult to lure executives back to public companies, since those who head private equity-owned firms typically must spend two to five years restructuring or building a business before "it's taken public and they get a big return," says Crist.

—John Helyar with Carol Hymowitz

The bottom line *Now that the recession is over, turnover in CEO suites is picking up. Boards today are often seeking leaders with new skills.*

Gaming

For Macau's Stanley Ho, A Family Feud

▶ With 16 kids from four "wives," the billionaire fights to retain control

▶ "You can't find another city where a single family" has such reach

From the moment you step on a plane or ferry to get to Macau, check into a new luxury hotel on the gaming mecca's waterfront, or dine at the city's three-Michelin-star restaurant, you will likely put money into the pocket of billionaire Stanley Ho. And that's before you hit the casino tables.

Ho's four-decade gambling monopoly, which ended in 2002, allowed him to build an empire that covers virtually every facet of the former Portuguese colony's economy. Even with recent competition from U.S. rivals such as **Las Vegas Sands** and **Wynn Resorts**, the Ho family takes more than 50¢ of every dollar bet in the enclave—the only part of China where casino gaming is legal.

"You can't find another city where a single family has such a high concentration in an industry that accounts for 40 percent of GDP," says Credit Suisse Group analyst Gabriel Chan. "And you can find their footprint in the other 60 percent as well."

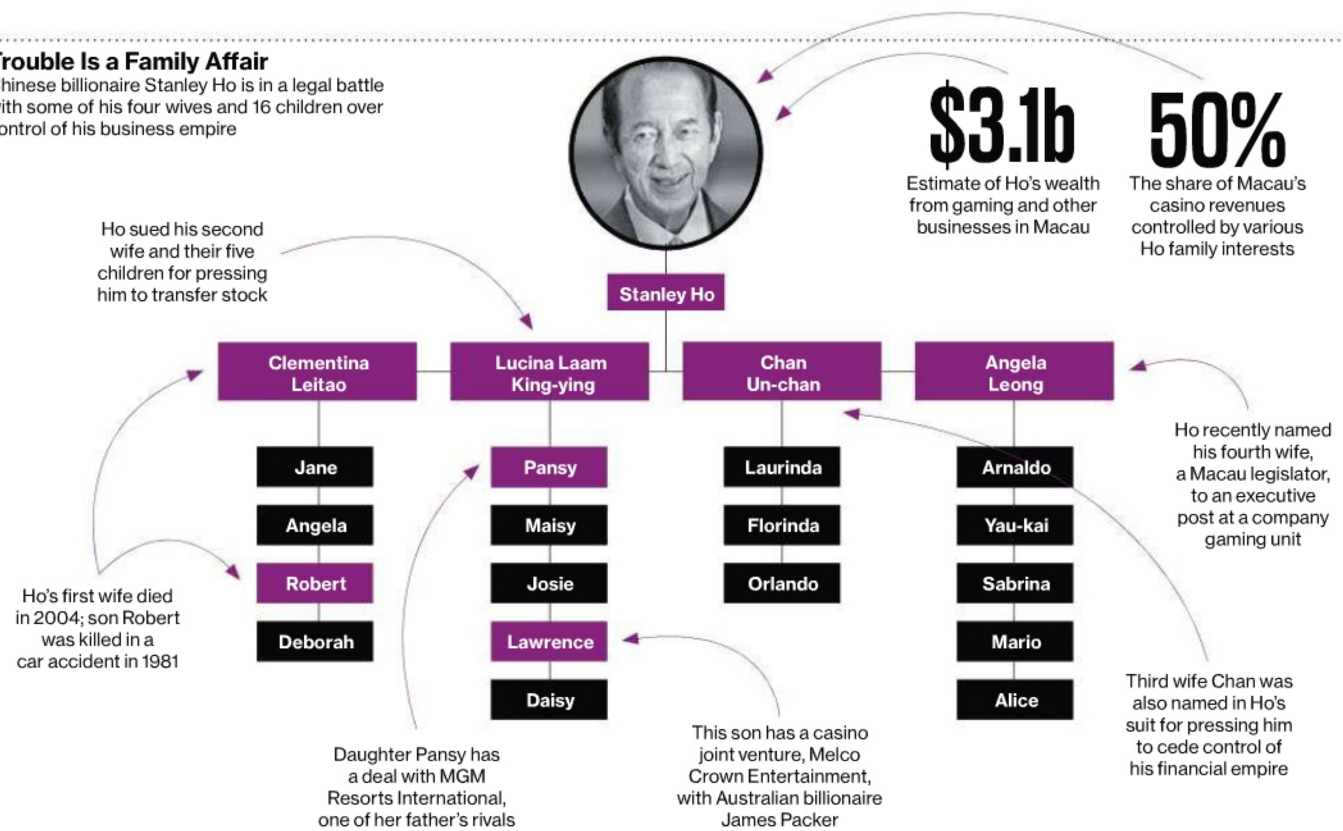
Now a battle is being waged over the empire by two of Ho's four "wives" and some of their 16 children. At stake is control of Ho's 31.7 percent holding in privately held **Sociedade de Turismo e Diversões de Macau**, or STDM, which has stakes in casinos, construction, luxury hotels, and Macau's airline.

The family feud became public on Jan. 24 after Ho, 89 and ailing, accused two of the women he calls his "wives" (his one legal wife died in 2004) and some of his children of trying to seize control of **Lanceford**, the family company that holds his STDM stake. He said the power grab went against his wishes that his fortune be shared among his four families.

Named in a suit Ho filed in Hong Kong are third "wife" Chan Un-chan, second "wife" Lucina Laam King-ying, and her five children including Pansy and Lawrence, who have gambling interests of their own in the city. Pansy, 48, has a joint venture with **MGM Resorts International** that has

➜

Trouble Is a Family Affair
Chinese billionaire Stanley Ho is in a legal battle with some of his four wives and 16 children over control of his business empire



VINCENT YU/AP PHOTO


Smarter business for a Smarter Planet:
What 99.9% system uptime means to a kilo of gold.
It means that the futures contract for that gold can trade instantly and more securely. The Dubai Gold & Commodities Exchange (DGCX) has maintained their complex network of worldwide members for four years without a single security breach due to malware, and without any unplanned downtime. The DGCX worked with IBM Security Solutions to help implement an intrusion prevention system that builds security into every aspect of their online trading services and proactively adapts to ever-evolving threats. A smarter business is built on smarter software, systems and services.
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From envoy to Presidential candidate? page 38 ▶

about a 15 percent market share, estimates Credit Suisse's Chan. Her 34-year-old brother, Lawrence, has a 50-50 partnership with Australian billionaire James Packer in **Melco Crown Entertainment,** which controls an additional 10 percent of the market. Also named in the suit are their sisters Maisy and Daisy, both executives of another publicly traded part of their father's empire, **Shun Tak Holdings**.

Ho said in a video interview with his lawyer on Jan. 25 that the relatives named in the suit had bullied him into signing a document transferring Lanceford shares to them in what amounted to "something like robbery." His stake in the family company was diluted from 100 percent to just 0.02 percent, according to Hong Kong records. The suit seeks a court order to bar the relatives from dealing in Lanceford shares.

Gaming is Macau's sweet spot; the city's $23.5 billion in gambling revenues last year was four times that of the Las Vegas Strip, according to government data. Ho built **SJM Holdings**, 56 percent owned by STDM, into Asia's biggest publicly traded gaming company. It operates 20 of Macau's 33 casinos, with a 32 percent market share, according to Chan.

STDM is the city's largest private employer, providing jobs to everyone from stable boys at the city's horserace track to sommeliers at the Michelin three-star Robuchon a Galera restaurant, where a plate of sautéed veal with black truffle jelly costs HK$1,480 ($190).

STDM's less glamorous holdings include a 33 percent stake in Macau International Airport and 14 percent of **Air Macau**, which brings gamblers from cities such as Beijing and Taipei. Shun Tak dominates the ferry and helicopter services that link the city to Hong Kong, and operates the buses to the Chinese mainland that brought more than half of Macau's 25 million tourists in 2010.

Ho, whose net worth is estimated by *Forbes* magazine at $3.1 billion, also earns money from Shun Tak's 50 percent stake in One Central, a complex of seven 40-story luxury apartment buildings and the Mandarin Oriental Macau hotel that dominates the waterfront on the Macau peninsula. Gambling revenue also flows to Ho through his ownership of the horse-racing track, run by the Macau Jockey Club, and the Canidrome greyhound-racing arena. Thrill seekers can ascend the city's tallest building, Shun Tak's 1,109-foot Macau Tower, which sits on land reclaimed by STDM, and then launch themselves off the world's highest urban bungee plunge.

Even in death, there's no escape from the reach of Ho's empire: Shun Tak says it is building a columbarium for the cremated remains of people from China and land-scarce Hong Kong and Macau on an island south of the city. *—Frederik Balfour with Debra Mao*

The bottom line *Stanley Ho is battling some of his four "wives" and 16 children for control of an empire that touches almost everything in Macau's economy.*

HUNTSMAN: CHARLES DHARAPAK/AP PHOTO



Retailing

Gap's High-Risk Housecleaning

▶ **The retailer gets new management and an ad agency for its U.S. brand**

▶ **Looking for an Antidote**

Change in same-store sales for Gap Inc.



DATA: GAP INC.

"Who am I?" That's how Art Peck began his first blog post as the new president of **Gap**'s long-troubled North America retail store unit. "If you Google me, you won't find much." Yes, there's the MBA from Harvard, two decades spent at **Boston Consulting Group**, and his tenure as a Gap executive since 2005 helping craft international strategy and leading its small outlet division. However, there's a surprising hole in his vita: He's not a style guru. "That's right. I'm not a merchant," he wrote in his debut blog.

Those aren't exactly words that inspire confidence in retailing. "That's not the first thing I want to hear," says Christine Chen, a retail analyst at Needham & Co. In the apparel business, the merchants translate the ephemera of fashion into must-have commercial products. Unfortunately for Gap, it hasn't had a successful merchant since Mickey Drexler, now chairman of **J. Crew Group**, left the company in 2002. That's led to years of disappointing sales for its U.S. unit.

Yet when Gap Chief Executive Officer Glenn K. Murphy announced on Feb. 2 that Peck would replace Gap North America President Marka Hansen, a 24-year veteran, it was obvious he was rolling the dice. In addition to Peck, Murphy appointed a new head of global marketing, Seth Farbman, who had been worldwide managing director at advertising agency **Ogilvy & Mather**. He also promoted another relatively unknown executive from within Gap's ranks. Pam Wallack, who had been the creative director for Gap's kids and adult clothing at its San Francisco headquarters, will move to New York to run what the company is calling a Global Creative Center. It will bring together for the first time the design, production, and marketing teams for the brand.

"This is a great opportunity for Wallack," says Richard E. Jaffe, managing director of Stifel Financial. "She's the chorus girl who got pulled out of the line to take the leading role." Will Murphy's gamble on untested talent work? "Who knows?" says Jaffe. "But if a tree is growing



Incoming President Peck: "I'm not a merchant"

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using your Plum Card to pay for a new employee named Ruben.



Bob Kearn, president of Coit Cleaning Services, was one of the first owners to get a Plum Card from American Express OPEN. Bob used the Card to buy everything from industrial equipment to cleaning supplies and new inventory. And with the savings from the 1.5% early pay discount, Bob was able to hire at a time when other companies were cutting back.

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in the wrong direction, you have to cut off a limb. I think that's what's happening here. It's not a bad thing."

Peck says his first priority is "to understand what's keeping us from being more consistent. We have to put clothes in our stores that our customers emotionally connect to. That's ... a statement of the profoundly obvious. If we don't do that, nothing else matters."

Murphy needed to think boldly after years of distracted management, aggressive expansion, and uninspired merchandise that have left the biggest apparel retailer in the U.S. weakened. It's been six years since Gap North America has posted an annual increase in sales at stores open at least a year, a prime measure of a retailer's health. During December, the height of the holiday selling season, Gap North America same-store sales dropped 8 percent. That's in sharp contrast to the average 3.2 percent gain at all U.S. retailers. Sales at the U.S. unit are down almost a third from where they were in 2004.

For the past year, Murphy has been expressing concern. In May he told investors on a conference call that Gap has been "on the longest slippery slope of all our brands." (The parent company also operates Old Navy, Banana Republic, Piperlime, and Athleta stores.) And in another investor call in August, he noted: "My patience is not indefinite."

Then in October, Hansen, who had led Gap North America for the past three years, unveiled a logo that had been selected in part by voting among consumers on the Web. It was criticized for being ugly, outdated, and unnecessary. A week later, Hansen said Gap would go back to its old logo.

With both a new management team and ad agency for the U.S. brand–Ogilvy & Mather will take over the Gap account, replacing **Laird + Partners**, which was involved in the logo mishap–Murphy has put in place changes more sweeping than many expected. Yet analysts say the changes need to kick in quickly. Explains Janet Kloppenburg, the founder of JJK Research, which specializes in retailers: "Their competitors are making inroads, developing loyal customers, and getting better and better, while Gap is starting over." —*Susan Berfield*

The bottom line *After years of sluggish sales and a flap over a logo switch, retailer Gap is changing management in an attempt to revive the brand.*

House parties help make guests receptive to brands



Marketing

House Parties With a Commercial Twist

▶ Big companies try in-home parties to generate buzz for their brands

▶ "If I give you a personal recommendation ... you don't argue"

On Jan. 29 six women converged on a brick, single-story home in Franklin Park, Ill., a working-class town about 14 miles northwest of downtown Chicago. As the temperature outside dipped below freezing, hostess Melanie Lindsey, 28, urged her guests to sample the Moscato white wine, savor the chocolate-dipped macaroons and bowls of candy hearts, and enjoy the party favors: an array of Durex condoms and lubricants.

That night, Durex sponsored some 5,000 condom bashes across the U.S. called "Durex Girl Talk House Party: Valentine's Day Edition." They were actually organized by the marketing firm **House Party**, which specializes in home product shindigs, a tried-and-true marketing strategy that dates back generations. At the Franklin Park gathering, Durex may have won a convert. Although "Trojan seems to be the go-to brand," said attendee Sarah Harper, the array of coupons, free samples, and customized beverage can sleeves trumpeting the condom maker's brand might tempt her to switch to Durex, a unit of Britain's **Reckitt Benckiser Group**. Reckitt declined comment for this story.

House Party's services are in demand these days. While the Irvington (N.Y.)-based outfit declined to provide specific figures, Chief Executive Officer Kitty Kolding says the number of gatherings it planned doubled in both 2007 and 2008. And over the past 18 months, she says, House Party has added **Anheuser-Busch InBev**, **Hasbro**, and **McDonald's** to a client roster that already included big consumer-focused marketers **Kraft Foods**, **Procter & Gamble**, **Ford Motor**, **Mattel**, and **Sony**.

Kolding says House Party has a database of about 900,000 potential hosts, who fill out online demographic profiles and compete to throw the product parties. Other than getting to share in the evening's array of corporate swag, they're not compensated. "Hosts feel like they've won," she says, "like they've got a backstage pass to the brand."

Corporate clients are willing to pay House Party an average of $250,000 for 2,000 parties because the company's staff uses such criteria as age, ethnicity, and breed of family dog to select the hosts best suited to talking up a certain product or brand, according to Kolding. That level of targeting is nirvana for those pitching consumer products–but often tough to achieve using conventional marketing.

Big brands are eager to reconnect with consumers after losing ground to private labels, which as of October had grabbed 22.3 percent of the U.S. market, according to market researcher Nielsen, up from 20 percent before the recession.

While companies such as Kraft, P&G, and **Kimberly-Clark** continue to pour money into TV and Web advertising, they're mindful that consumers are programmed to "resist the sales push," says Ronald C. Goodstein, a marketing professor at Georgetown University. "The advantage of word-of-mouth is if I'm giving you a personal recommendation because we're friends, you don't counterargue that." The downside, he says, is that partygoers may find brand-sponsored fetes a turn-off and wonder if their friends have sold out for the sake of some coupons and freebies.

Although the efficacy of this kind of bottom-up, buzz marketing is difficult to measure, companies will spend an estimated $2.2 billion on word-of-mouth marketing this year in the U.S., according to researcher PQ Media. That's 43 percent more than in 2008.

Kraft, which in November attracted more than 20,000 people to parties celebrating the company's Nabisco Nilla wafers cookies, plans to hold at least 25,000 brand bashes this year. The parties are "more cost-efficient" than television commercials, says Kelley Woodland, who runs consumer relationship marketing for Kraft's North American division.

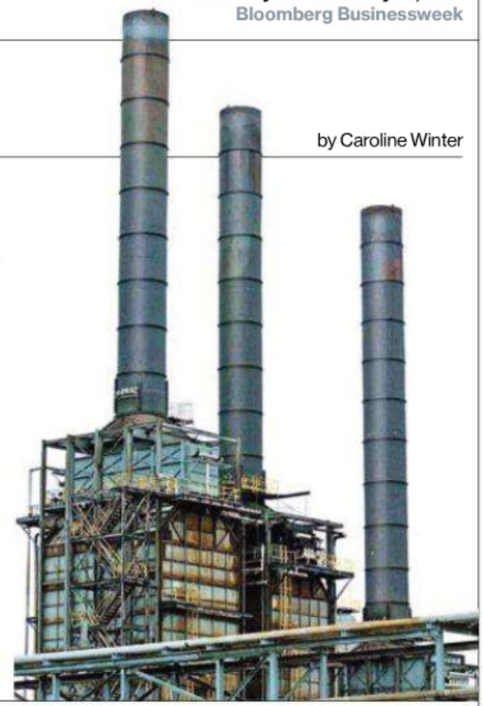
House Party's Kolding is looking forward to the company's next string of branded festivities, including a gathering celebrating **Schwan Food**'s Freschetta pizza, timed to coincide with the Academy Awards broadcast on Feb. 27. Then it's diapers and dancing for Kimberly-Clark's Huggies brand. The company is already touting the Pull-Ups "Potty Dance Day" House Party on Mar. 5, where hosts will get dance mats and a DVD, coupons, and coloring sheets. The evening's entertainment: Toddlers and parents alike will groove to a streamed concert of *The Potty Dance* by the children's rock band Ralph's World. Ⓑ —*Leslie Patton*

The bottom line *To combat growing interest in lower-priced house brands, consumer-products makers are using in-home parties to build buzz for their goods.*

OPPOSITE PAGE: PHOTOGRAPHS BY BRIAN ULRICH FOR BLOOMBERG BUSINESSWEEK; THIS PAGE, CLOCKWISE FROM LEFT: DANIEL ACKER/BLOOMBERG NEWS; JOHN ZICH/BLOOMBERG NEWS; CHRIS RATCLIFFE/BLOOMBERG; PRNEWSFOTO/NOKIA CORPORATION/NEWSCOM

Briefs

by Caroline Winter



BP
Reinstating the dividend

BP announced on Feb. 1 that it would reinstate its dividend, which it suspended last spring following the Gulf of Mexico oil spill. The British oil major is setting payments at 7¢ a share for the final three months of 2010, half the previous level. BP also said it's shopping two U.S. refineries, saying it hopes to gain at least $4 billion from the sales. Chief Executive Officer Robert Dudley has committed to making the company "smaller" and "more agile" but says he should not be bound by his predecessor's pledge to sell as much as $30 billion in assets. BP posted a $5.6 billion profit for the fourth quarter, compared with $4.3 billion for the same period a year earlier.

Roche
Avastin's prospects dim

$7.5 BILLION

Roche Holding cut its peak sales forecast for Avastin, the world's best-selling cancer drug, by about 20 percent as the U.S. Food and Drug Administration moved to revoke approval for its use in the treatment of breast tumors. The Swiss drugmaker won U.S. approval of Avastin for breast cancer in 2008 under an accelerated review. Yet trials conducted since haven't established that the drug slows progression of the disease. Roche now expects the drug to generate about $7.5 billion in annual sales, vs. a previous forecast of $9.6 billion.

EMI Group
A buyout ends on a sour note



Citigroup seized control of EMI as the British record label struggled to meet the terms of loans used to finance its takeover by Terra Firma Capital Partners. The U.S. bank will likely get $2 billion in any future sale, narrowly covering EMI's $1.94 billion debt, according to Needham Group analysts. Warner Music Group and BMG Rights Management are eyeing some of EMI's assets. In November, Terra Firma Chairman Guy Hands lost a court battle against Citigroup in which he claimed the bank misled him into overpaying for EMI.

Abercrombie, Aéropostale
No more monthly sales reports



Teen clothiers Abercrombie & Fitch, Aéropostale, and American Eagle Outfitters will stop releasing monthly sales figures as of March. The move may make it harder for investors to evaluate the companies. Many retail executives say reporting same-store sales (revenues from outlets open at least a year) puts too much focus on short-term results. Among the companies that have put an end to the practice, which is voluntary, are: Ann Taylor Stores, Chico's FAS, Pacific Sunwear of California, and Wal-Mart Stores.

Nokia
On the verge of a ratings downgrade



Nokia, the world's No. 1 maker of mobile phones, may have its credit rating lowered for the first time. A recent report by Standard & Poor's noted that Nokia's declining global market share in smartphones—down to 31 percent in the fourth quarter from 40 percent a year earlier—puts it at risk for a downgrade. Nokia faces intensifying competition from Apple's iPhone and handsets that run on Google's Android platform. Android overtook Nokia's Symbian to become the No. 1 operating system for smartphones at the end of 2010.

On the Move

JBS **Wesley Batista to replace his brother Joesley Batista as CEO**

CareFusion **Ex-ResMed CEO Kieran Gallahue named CEO, effective Jan. 28**

Affiliated Managers Group **COO Nathaniel Dalton named president**

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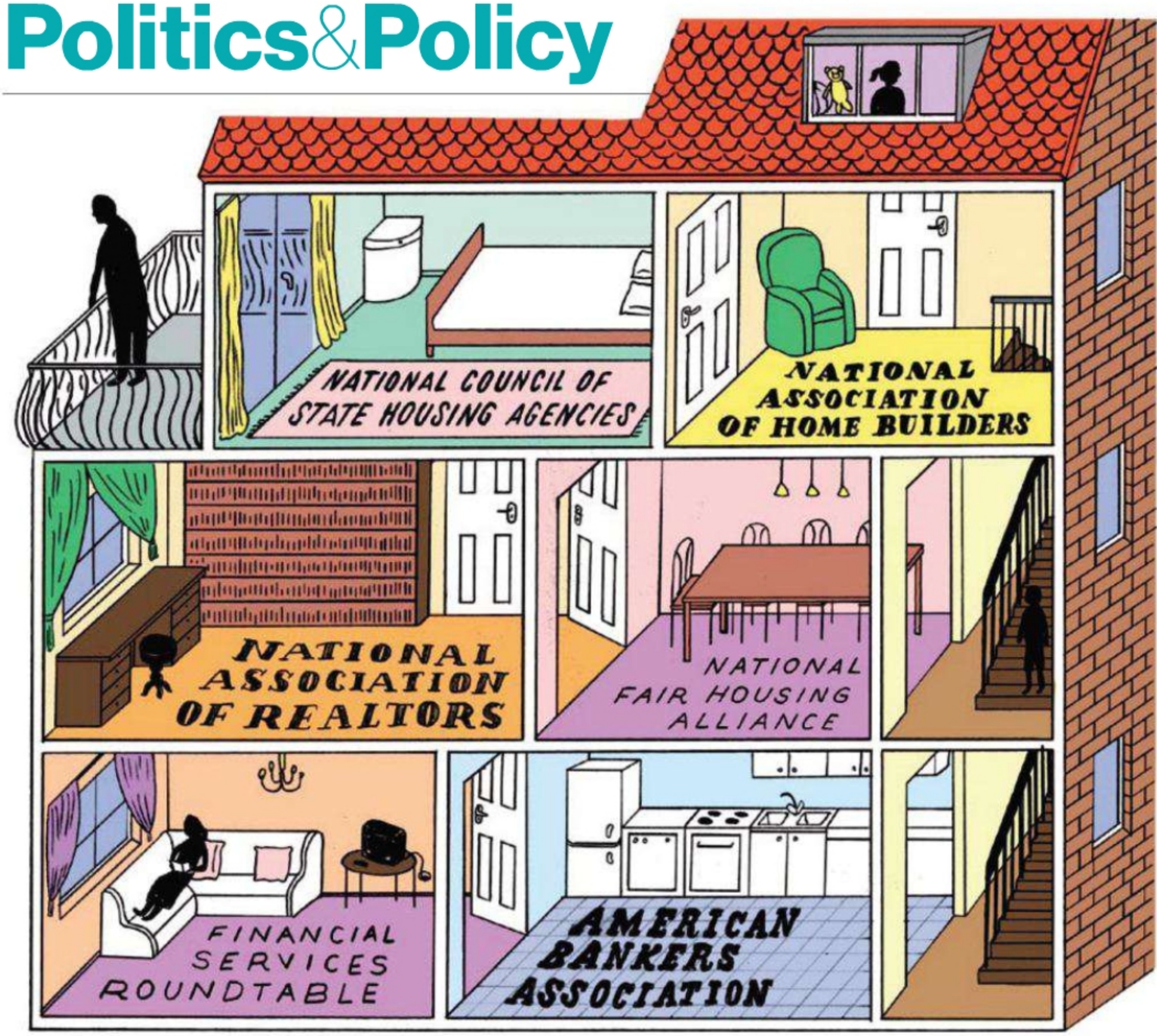


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The Real Estate Lobby Is Ready to Rumble

▶ **Financiers, homebuilders, and real estate agents are uniting to save mortgage subsidies**

▶ **"We're preparing for one hell of a fight"**

ILLUSTRATION BY SOPHIA MARTINECK

Barbara J. Thompson plans to put a human face on the high-stakes debate over whether to preserve cherished U.S. government subsidies for home loans. Hundreds of faces, in fact. Next month, she'll lead a legion of "everyday people" to Capitol Hill to affirm the virtues of homeownership and urge Congress not to abandon federal support for low-cost mortgages. "These are your neighbors, they're the people who teach your kids at school, they're your firefighters," says Thompson, executive director of the National Council of State Housing Agencies, whose members help provide loans to first-time home buyers. "The middle working class is the bedrock of our country."

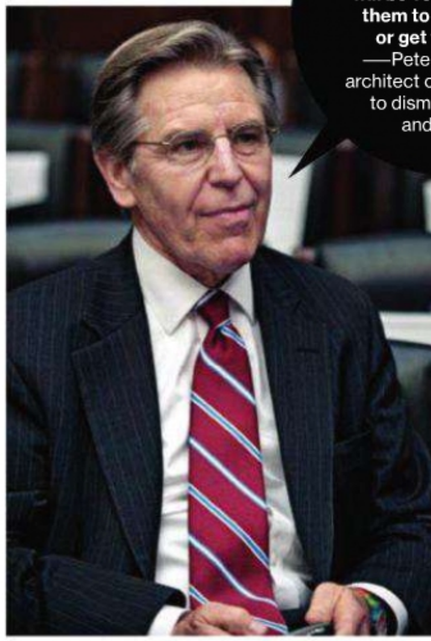
Joining Thompson's cause will be thousands of homebuilders, real estate agents, civil-rights leaders, and bankers who aim to deliver a similar message to Congress: Preserve government support for housing. Together, these groups represent what one might call, with apologies to President Dwight D. Eisenhower, a real

estate-industrial complex that transcends partisan politics, geography, and socio-economic divides.

What unites them is a desire to protect a near-century of grants, tax breaks, and insurance policies funneled in large part through the government-owned mortgage-finance companies **Fannie Mae** and **Freddie Mac**, which played starring roles in the U.S. housing crisis. Fannie and Freddie bought home loans from banks and sold them to global investors with an implicit government guarantee to cover losses in the event of a default. The arrangement helped foster an $11 trillion mortgage industry and supported a housing sector that overheated—and then started unraveling in 2008.

Now as lawmakers begin to overhaul the system, the housing lobby is mobilizing against its common enemy: a Republican plan to eliminate the federal government's guarantee of mortgages. "It's a coalition that's going to be very difficult for our adversaries to beat," says Jerry Howard, president and chief executive officer of the National Association of Home Builders. "We're preparing for one hell of a fight."

The group includes financiers who want to keep capital flowing on Wall Street, legions of real estate brokers and builders whose incomes depend on a robust housing market, and activists committed to the cause of shelter as a basic right. Among the ranks are some of Washington's biggest players, including the National Association of Realtors, whose members donated $3.9 million to candidates in the last election cycle, making it the nation's biggest political action committee. Then there's the American Bankers Assn., another powerhouse, which spent $6.2 million on lobbying last year, according to the Center for Responsive Politics. "It's David and Goliath," says Daniel J. Mitchell, an economist at the free-market Cato Institute who favors eliminating the government guarantee. "Not all hope is lost, but I'm not brimming with optimism."



The housing industry "will say that without the government's backing it will be very difficult for them to build homes or get financing."
—Peter Wallison, an architect of the GOP plan to dismantle Fannie and Freddie

On Feb. 16, the National Fair Housing Alliance, a civil-rights coalition, will bring together the Financial Services Roundtable and the Center for American Progress, a think tank aligned with the Obama Administration, along with other influential players to explore areas of common interest. The mortgage guarantee will be one of them, says Deborah Goldberg, who is leading the alliance effort. "Eliminating the government role in the secondary market is not the fix anybody is looking for," Goldberg says.

Lax subprime lending standards and conflicts between the public's interest and obligations to shareholders helped drive Washington-based Fannie Mae and Freddie Mac, based in McLean, Va., to the brink of collapse in 2008. The U.S. Treasury Dept. took control of the companies that year and has since advanced them $151 billion in taxpayer money to keep them solvent. Fannie and Freddie spent more than $164 million on lobbying in the decade leading up to the financial collapse. They now are banned from influencing Congress.

The real estate-industrial complex is doing that for them. In fighting to preserve some level of government insurance on mortgages, housing lobbyists are defending a crucial role played by Fannie and Freddie in greasing Wall Street's securitization machine. The duo now owns or guarantees more than half of all U.S. mortgages.

This month, Treasury Secretary Timothy Geithner will formally kick off the public debate when he presents

The Real Estate-Industrial Complex

Real estate agents, home builders, Wall Street banks, community banks, and civil rights groups have been lobbying Congress to maintain various federal subsidies on mortgages.

American Bankers Assn.
Representing banks of all sizes, it spent more than **$6.2** million on lobbying in 2010

Financial Services Roundtable
Lobbyists for banks and nonbank financial companies with **$92.7** trillion in total assets, including Bank of America, General Electric, and Wells Fargo

National Association of Realtors
A trade group with 1.1 million members, its political action committee contributed **$3.9** million during the 2010 midterm election cycle, more than any other PAC

National Association of Homebuilders
A Republican-leaning federation that helped House Financial Services Committee Chairman Spencer Bachus (R-Ala.) raise nearly **$200,000** from the housing industry, the top donor to his 2010 reelection campaign

National Fair Housing Alliance
Steers a coalition of more than **20** civil-rights groups, including the NAACP, in an effort to preserve access to fair credit and homeownership

National Council of State Housing Agencies
These state government boards have more than **$115** billion in bonds outstanding to aid first-time home buyers. They plan a lobbying campaign in March to highlight who benefits from low-cost mortgages

DATA: BLOOMBERG, CENTER FOR RESPONSIVE POLITICS

FROM LEFT: MANNIE GARCIA/BLOOMBERG; ARTHUR S. AUBRY/PHOTODISC/GETTY IMAGES

Congress with a range of options for reducing the government's role in home financing while also encouraging Wall Street firms to take on some of the risk. Administration officials call the document "a path" to fixing housing finance and are lowering expectations that they will provide a magic bullet.

Republicans and their free-market allies want the mortgage system to stand on its own, and they've targeted the government guarantee for extinction. The House Financial Services Committee plans to begin hearings on Feb. 9. "There can't be any explicit guarantee," says Representative Scott Garrett (R-N.J.), who will have a lead role in housing legislation. "The taxpayer has been on the hook for this credit risk for a long time."

For Garrett and other Republicans, withstanding the lobbying onslaught might be difficult. Homebuilders and real estate agents in particular tend to support Republicans, according to the Center for Responsive Politics, and both groups are enlisting local business leaders and donors to make their case directly to lawmakers. "We're looking to make the arguments in a very personal way with each congressman," says Ronald Phipps, president of the National Association of Realtors. "We represent not just the 1.1 million Realtors and the 46 million consumers who have mortgages but also the 75 million homeowners in the U.S.," Phipps says.

Realtors and builders also have a simple message that resonates with lawmakers, says Peter J. Wallison, a former Treasury Dept. official and an architect of the Republican plan to dismantle Fannie and Freddie. That message comes down to: One wrong move, and home sales and construction could come to a halt, unsettling the economy just as it seems to be recovering from the Great Recession. Even small-government idealists, such as Tea Party conservatives, could be sympathetic to such bread-and-butter arguments. "They will say that without the government's backing it will be very difficult for them to build homes or get financing for mortgages," Wallison says. "We have a very, very difficult road ahead of us."

—*Lorraine Woellert*

The bottom line *A vast housing lobby will fight to retain mortgage subsidies as Republicans seek to privatize Fannie Mae and Freddie Mac.*



Fiscal Policy

Playing Chicken With Deficits and Debt

- **The White House and congressional Republicans draw lines in the sand**
- **"The only question is: Who's going to blink first?"**

President Barack Obama, Treasury Secretary Timothy Geithner, and even Republican House Speaker John Boehner all agree: Failure to raise the $14.3 trillion debt ceiling would cause a fiscal apocalypse, wreck the good faith and credit of the U.S. for decades, and destroy millions of jobs. Yet Republican Representative Paul Gosar, an Arizona dentist who rode the anti-Washington Tea Party wave into office in November, isn't buying it. "I think there's a lot of question as to that doom and gloom," he says.

With the U.S. projected to reach the statutory ceiling sometime between Apr. 5 and the end of May, the biggest uncertainty isn't whether Congress will raise the limit but what it will take to persuade Republican insurgents such as Gosar to get with the program. "Raising the ceiling is virtually inevitable," says Stan Collender, a former congressional budget analyst and managing director at Qorvis Communications in Washington. "The only question is: Who's going to blink first?"

A first skirmish could come within weeks. Stopgap funding for the current fiscal year runs out on Mar. 4. In exchange for approving an extension, some Republicans are demanding cuts ranging from $60 billion to $100 billion in non-security discretionary programs this fiscal year, which ends Sept. 30. The White House, however, has signaled it will resist any cuts beyond the five-year freeze in discretionary, non-security spending Obama proposed last month, which would save $400 billion over the next decade. In addition, the President made clear he would oppose any attempt to scale back entitlements such as Social Security or Medicare. And cuts in programs that make up his new innovation agenda–education, research, and infrastructure spending–aren't up for discussion.

Some Tea Party Republicans may relish the opportunity for a deadlock with Obama leading to a government shutdown. That's an outcome Boehner will seek to avoid: In 1995, he had a front-row seat to the public outrage directed at his party when it forced a government shutdown in a confrontation with President Bill Clinton.

Nonetheless, Boehner and

other Republican leaders, who owe their House majority to the Tea Party, remain intent on using the threat of default to push Democrats to slash spending. Failing to raise the debt ceiling would be "a financial disaster," Boehner said on Fox News on Jan. 30. But "if the President's going to ask us to increase the debt limit, then he's going to have to be willing to cut up the credit cards."

Where Boehner would use scissors, some in his party advocate breaking out a chainsaw. Senator Pat Toomey, an antitax freshman from Pennsylvania, has proposed requiring the U.S. to pay interest on the debt before any other federal spending. This would allow the government to avoid raising the debt limit, he claims, and at the same time reduce by one-third the amount of money available in the budget, forcing drastic cuts. Treasury officials have said Toomey's idea is "unworkable." Illinois Senator Mark Kirk is pushing to hold a series of votes extending the ceiling for a month or two, with each one tied to deeper spending curbs.

That may not play too well in financial markets. To prevent a default, Geithner has tried to build relations with key congressional Republicans. Since January, he has spoken or met with House Speaker John Boehner of Ohio, Ways & Means Chairman Dave Camp of Michigan, Majority Leader Eric Cantor of Virginia, and Budget Committee Chairman Paul Ryan of Wisconsin. Treasury also has taken steps to put off hitting the debt limit. Last week, the department announced that it expects to borrow $237 billion during the first quarter, less than previously estimated. The lower projection was a result of Treasury scaling back a special Federal Reserve borrowing program, freeing up more headroom to finance government operations. Treasury aides say the department will consider other delaying tactics.

$400
BILLION

Projected savings from Obama's 5-year discretionary spending freeze

—Lisa Lerer with Rebecca Christie

The bottom line *Both party's leaders support raising the debt ceiling. The Tea Party is attempting to use the ceiling to force spending cuts.*

Foreign Aid

The Lobbyists Watching Egypt's Back

- **Tony Podesta helped Mubarak keep U.S. aid flowing**
- **"Egypt has always been good at promoting its own interests"**

Until a popular revolt put his control of Egypt in jeopardy, President Hosni Mubarak had kept a tight grip on power and billions of dollars in U.S. aid flowing with few strings attached, in part by retaining three of Washington's most high-powered lobbyists.

Since Egypt hired the lobbyists in 2007, Congress softened a condition on the foreign aid, added in 2005 over Mubarak's objections, that barred his government from choosing which pro-democracy groups should receive $20 million of Egypt's $1.8 billion in U.S. aid. That restriction became harder to enforce in 2009 when Congress barred all foreign governments from determining who could get such grants. U.S. pro-democracy programs in Egypt ultimately had little effect, a 2009 Agency for International Development audit concluded, because of a "lack of cooperation" by the Egyptian government.

The three lobbyists are Tony Podesta, who has close ties to the Obama Administration, former Republican representative Bob Livingston, and former Democratic representative Toby Moffett. The three formed a joint venture, PLM Group, to represent Egypt in Washington, according to foreign-agent records at the Justice Dept. They were paid $1.1 million a year, says a person familiar with the company.

"Egypt has always been good at promoting its own interests," says Graeme Bannerman, who was the country's top lobbyist in Washington for 17 years before it hired PLM. "Considering how few Egyptian-Americans there are here," he says, the Egyptians "have done a very good job of explaining to Americans why the relationship is so important to the two countries." With PLM, Bannerman says, the Egyptians got "a little more flash" and "increased their firepower."

The PLM contract was for "promoting and safeguarding" the Egyptian government's interests in the U.S., including "maintaining the amount of U.S. military and economic aid to Egypt," according to a draft retainer agreement on file at Justice. Records show PLM staff made 1,873 contacts with lawmakers, their staffs, or Administration officials between 2007 and 2010.

Hiring PLM coincided with debates in Congress about the future of U.S. military and economic aid to Egypt and whether to tie it to improvements in human rights. Egypt "clearly" pushed back on the 2005 language that prohibited it from choosing the civic groups to receive grants to promote democracy, Bannerman says. A congressional aide, who spoke on background to discuss a foreign government matter, says the Egyptians "were upset" when former



Tony Podesta formed a joint venture to promote Egypt's interests

LUKE SHARRETT/THE NEW YORK TIMES/REDUX

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BW-401(K)

Zero revenue, millions of users page 43 ▶



Representative David Obey (D-Wis.) threatened in 2007 to cut some of the country's foreign aid. Obey was "fed up with the lack of progress on democracy," the aide says. Obey, who retired at the end of last year, confirmed he tried to cut Egypt's military aid to win progress on human rights, and backed off when Mubarak released a political dissident from prison. Obey says he recalls telling both Mubarak and his son, Gamal, that "if they didn't open up the society they would wind up risking being blown out" by political revolution. The Mubaraks, Obey says, "were not very much interested in the message."

At the time, U.S. aid to Egypt was declining. It fell to $1.55 billion in 2010, from $2.1 billion in 1998, according to a Congressional Research Service report. Its military might in the region was also under threat. Three months after the lobbying venture was formed in April 2007, the Bush Administration signed an agreement to increase its military aid to Israel. A year later the U.S. concluded a similar deal with Jordan. Livingston, Moffett, and Podesta declined to comment. Moffett, who represented Connecticut and now heads the Moffett Group, told *The Hill* newspaper before Mubarak's decision to step down that the group planned to continue to represent Egypt.

The three have strong ties to Washington and past Administrations. Podesta, who runs his own firm, Podesta Group, is the brother of John Podesta, a White House chief of staff under President Bill Clinton. Podesta Group is often ranked by public interest groups as Washington's highest-revenue lobbying firm. Livingston, who represented Louisiana and now runs the Livingston Group, chaired the House Appropriations Committee from 1995 to 1998.

It's routine for foreign countries to hire lobbyists, and Egypt spends less than other governments. The United Arab Emirates spent $10.9 million in 2008 lobbying Washington, according to the Sunlight Foundation, a watchdog group. It was followed by Britain, which spent $6.1 million, and Japan, which paid out $4.2 million.

—James Rowley and Lizzie O'Leary

The bottom line *Washington superlobbyist Tony Podesta and two former congressmen helped Egypt fend off Capitol Hill critics.*

Diplomacy

The GOP's China Hand Comes Home

▶ **Mulling 2012, Ambassador Jon Huntsman is leaving Beijing**

▶ **"You sometimes can measure progress by stopping bad policies"**

In his Beijing office, U.S. Ambassador to China Jon Huntsman keeps a wall-hanging emblazoned with the characters *hu xiang bang zhu, hu xiang xue xi*, which means "help each other, learn from each other." As Huntsman prepares to leave his post on Apr. 30. for a possible White House run in 2012, his hosts hope that what he has learned during his 18 months in China will help foster warmer ties between Beijing and Washington. "If he's elected, we'll be happy," says Sun Zhe, director of the Center for U.S.-China Relations at Beijing's Tsinghua University. "I trust him. No matter what he does, he will continue to care about this relationship."

Huntsman, 50, leaves as perhaps the most prominent U.S. envoy to China since George H.W. Bush headed the Beijing mission almost four decades ago. He has won respect from the Chinese, who praise his efforts to boost ties between the world's two biggest economies, even as executives credit him with helping to fend off rules that would have made it harder to do business in the mainland.

The former Utah governor, who learned Chinese as a Mormon missionary in Taiwan and adopted a Chinese daughter, has been treated to glowing profiles in Chinese magazines. He likes to tell reporters about rides on his Mao-era Forever-brand bicycle down Beijing's alleyways, and peppers his speeches in China with American-accented phrases in Mandarin. Huntsman has made a "definite contribution" to Sino-U.S. ties, Foreign Ministry spokesman Hong Lei told reporters on Feb. 1.

Even so, business executives say he hasn't been a pushover.



Huntsman

Shortly after his arrival in August 2009, Huntsman brought together European and Asian diplomats and dozens of trade groups to craft a coordinated response to Indigenous Innovation, a program designed to promote homegrown technology. The new rules threatened to shut foreign companies out of China's $112 billion government procurement market. After months of pressure, China last April said it would delay implementation of the regulations. "He knew China, so nobody could fool him," says James McGregor, a former chairman of the American Chamber of Commerce in China who is a senior counselor at consulting firm APCO Worldwide. "In China you sometimes can measure progress by stopping bad policies in their tracks."

As a son of the founder of Huntsman Corp., an $8 billion chemical producer, Huntsman is well-versed in the needs of business. "You have to listen very closely to what the business community is saying on [Chinese regulations] because they are out there on the firing line … trying to make their ventures work," Huntsman said in an interview last June in his office, where a model of a FedEx plane sits on his desk to remind him of the company's troubles breaking into the Chinese express-mail market. "We can bring some clarity to the issue for the Washington policy makers."

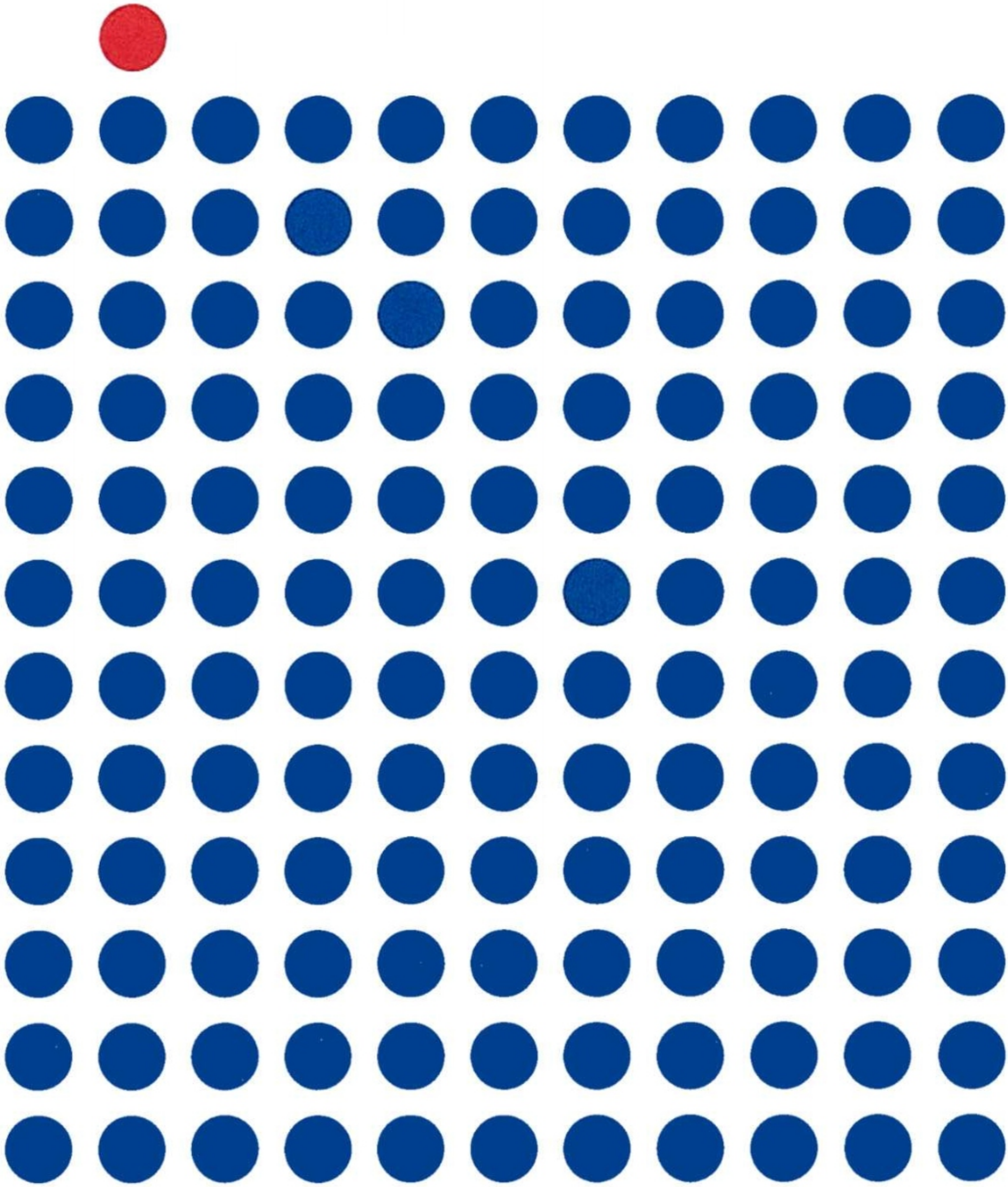
He hasn't done much to help narrow trade imbalances during his tenure, even though China in June allowed the yuan to start appreciating after two years during which it was virtually pegged to the dollar. (The currency has advanced more than 3 percent since then.)

Nonetheless, says AmCham-China President Christian Murck, Huntsman has been instrumental in bridging the gaps separating American and Chinese policy makers and businesspeople, and focusing them on realistic goals. In December he helped obtain a Chinese pledge to work on an agreement to end restrictions on American beef and poultry imports, as well as assurances that China would reduce software piracy. The ambassador, says Murck, has managed to get U.S. business to work on priorities that "the Chinese can reasonably be expected to deliver."

—Michael Forsythe

The bottom line *As U.S. Ambassador to China Jon Huntsman mulls a run for the White House, Americans and Chinese alike praise his skill.*

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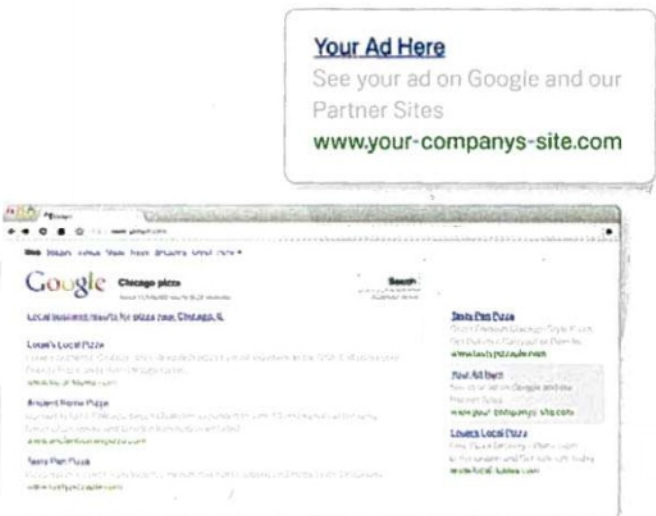
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Politics&Policy

Regulation

Risky Businesses

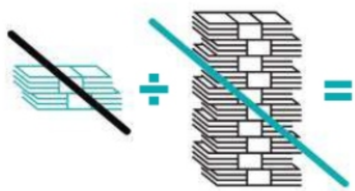
Congress last year ordered U.S. bank regulators to figure out which financial companies are the riskiest and then turn the list over to the Federal Reserve so they can be supervised more closely. The Fed, the Treasury Dept., and nine other regulators on the Financial Stability Oversight Council this spring will reveal the criteria they plan to use to decide which financial companies to tag as systemically risky; the companies will be named later this year. Economists at New York University's Stern School of Business have derived their own list, based on a model that one of them, Nobel Prize winner Robert Engle, helped develop. The model starts with a financial firm's stock price as a proxy for its capital–the money it has to make loans, buy bonds, or absorb losses. They then subject each company to a stress test, in which the stock market declines 40 percent, to find how much capital a company would need to continue holding the same amount of loans and bonds. One downside to the model: It only works for publicly traded companies, so it won't help regulators decide whether most hedge funds should make the list. —*Craig Torres*

How their formula works:

The model defines a "crisis" as a market decline of 40%, which is what happened in 2008-2009



The capital needed by each firm is divided by the $370 billion in capital some of the 100 firms in the model would need in a 40% stock market decline

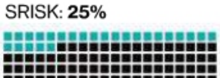


The percentage contribution of each firm to the total capital shortfall is the Stern Systemic Risk Contribution or "SRISK"



1 Bank of America

SRISK: **25%**

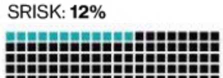


America's biggest bank with $2.3 trillion in total assets.

"Bank of America has made significant progress over the last year" to strengthen its capital and reduce risk, says spokesman Jerry Dubrowski.

2 JPMorgan Chase

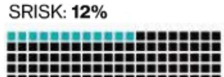
SRISK: **12%**



Second-biggest U.S. bank by assets. The NYU model shows its market value would fall almost 5 percent in a stock market decline of at least 2 percent.

3 Morgan Stanley

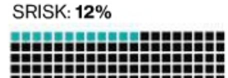
SRISK: **12%**



The NYU model shows the Wall Street bank is highly leveraged, with about $22 of assets sitting atop every $1 of stock market value.

4 Citigroup

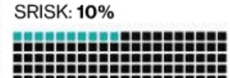
SRISK: **12%**



Third-largest U.S. bank with nearly $2 trillion in assets. The NYU model shows the stock tracks the overall stock market more closely than most financial firms.

5 Goldman Sachs

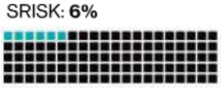
SRISK: **10%**



The firm cut the size of its trading bets last year. Still, the NYU model shows the stock would lose about 5 percent of its value if the overall market declines at least 2 percent, an indicator of possible erosion of capital.

6 MetLife

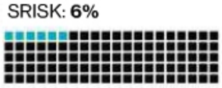
SRISK: **6%**



The economists' model shows the insurance company would lose more than 6 percent of market value in a market decline of at least 2 percent.

7 Prudential Financial

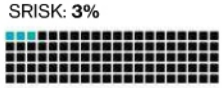
SRISK: **6%**



The NYU model shows the company is highly leveraged with $33 of assets for each $1 of stock market value, making its capital vulnerable to shocks.

8 Sallie Mae (SLM)

SRISK: **3%**

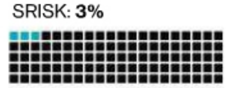


The student loan company has the highest leverage in the NYU model with almost $38 dollars of assets for each $1 in stock market value.

Martha Holler, a Sallie Mae spokeswoman, says the model neglects unique factors of the company's business, including that more than 80 percent of its assets are government-guaranteed.

9 Hartford Financial Services

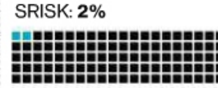
SRISK: **3%**



The company is risky because it is highly leveraged, with $28 dollars of assets for every $1 of stock market value.

10 Wells Fargo

SRISK: **2%**



The fourth-largest U.S. bank with $1.2 trillion in assets scores 10th because the model shows its leverage is low with $9 of assets for every $1 of market value. That means its need for capital in a financial shock may be less severe than others'.

*Spokespersons at every firm except Bank of America and SLM declined to comment.

DATA: NEW YORK UNIVERSITY STERN SCHOOL OF BUSINESS (HTTP://VLAB.STERN.NYU.EDU/ANALYSIS/RISK.USFIN-MR.MES)

Charlie Rose talks to Bill Gates

“We spend 17.8 percent of our GDP on health care ... just mind-blowing”



On the day he released his $34 billion foundation’s annual report, Gates talks about his planetwide battle against disease—and assesses America’s economic prospects

Your sights are now set on fighting polio. Why?
Well, the Foundation does work on lots of health issues. The one that’s our top priority, though, is polio because we have a chance now—if we stay the course—to drop the number of cases to zero, to eradicate the disease. And if we don’t really execute well in these next several years, it’ll spread. ... And then we’ll be back to having 100,000 or more cases of kids dying or being paralyzed.

How do you define eradication?
It means zero, none, gone. And that’s only happened with one human disease—smallpox.

Conquering a disease like that sends a signal, doesn’t it?
If you improve health, you do three things for children. You save the lives, and that’s big. The second is there’s lots of the kids who survive who are damaged; their brains never develop. And finally, the one that’s the most amazing is that if you improve health, parents choose to have fewer kids. So instead of better health growing the population, it’s actually the only thing we’ve ever come up with that actually shrinks population growth. That’s the only way you get your hands around all the big issues. Can you educate them all? Can you provide them all jobs? So from a human and an environmental perspective, this health stuff is the most leveraged thing there is. Polio would energize that. It would show we can get something hard done.

Let’s shift to malaria. Has your opinion changed on that front?
The year I was born, 1955, the World Health Assembly resolved to eradicate malaria. That’s partly why people were reluctant to take on smallpox. Malaria made them look bad. With malaria, you have to think in terms of a 15-, 20-year time frame. The Bill & Melinda Gates Foundation is spending hundreds of millions a year on the tools. The tools include a vaccine, and we have one that’s in a late-stage trial now. You have to have really cheap diagnostics so you can find out who’s carrying the parasite. There’s really good progress, [but] you’ve got to get polio done first.

Education is another target of yours. What are the big hurdles there?
I’m very excited that ... there will be a way of measuring teachers and showing teachers how to improve. I don’t know when exactly that will catch on, but by using videos and surveys I feel very good that the work that we’re helping to back will make a huge contribution to identify what it is that great teachers do. The difference is awareness of when the kids start to get bored. That interactive element is so strong in these great teachers, and people can learn to do that better.

What do you conclude about U.S. spending on health care vs. the rest of the world?
We spend 17.8 percent of our GDP on health care. And the next highest is at 12 percent. You have some, like Britain, who are down at 9 percent. That is just mind-blowing. And our outcomes aren’t better. The incentive system exists to have all sorts of ways of spending money on 70-year-olds and 80-year-olds—spend $100,000 on this, spend a half-million dollars on that. You’re taking resources away from the young. Anything you can invent, we have no metric that would hold us back. So, innovation is inventing ways of taking resources away from the young, whether that’s education or anything else.

Do you expect to see an American state declare bankruptcy?
That’s tricky. From a pure accounting point of view the answer would have to be yes. If you take Greece’s fiscal problems and you take Illinois, New Jersey—it’s very, very similar.

Is there the political will to do something about the deficit?
Look, you have to cut spending. We’re up to [a deficit of] $1.5 trillion a year. I wish I was innumerate. These numbers are truly upsetting.

Technology has been good to the U.S. Are we losing our momentum?
We’d have to keep making a lot of mistakes for several decades before we’d lose that edge. It’s great that other countries are more innovative. When my child gets sick, I won’t look at the pill and say, “Oh, my gosh, it’s made in China.” If they invent something that can save my child’s life, I’ll say, “Hallelujah.” But the U.S. lead is very strong. Our universities, our funding of research, it’s pretty amazing. Smart people still want to come to this country. Do we make it as easy for them as we ought to? I don’t think so. But we have time to renew our excellence in how we educate, the excellence of our immigration system, in how we invest in young people. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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Contents ▶ A European shadow on China's solar industry 44 ▶ The woes of being an AOL e-mail user 45 ▶ Is WikiLeaks hacking into hard drives? 46 ▶ Innovator: Roger Curtis's test bed for next-generation vehicles 48 ● Edited by James Aley

Technology

Zero Revenue. Four Staffers. 1.75 Million Users

▶ In the hyper-competitive world of photo sharing, Instagram leaps ahead

▶ "People are now sharing their lives as they happen"



Instagram co-founders Mike Krieger (left) and Kevin Systrom

Early Bird
Instagram filter that gives photos an antique look without too much sepia

Over the past decade, the market for photo-sharing services on the Internet has come to resemble a relay race, with one service after another rising to prominence and then passing the baton of buzz and leadership to a more innovative newcomer. Photo upload sites such as **Ofoto** and **Shutterfly** dominated the field in the late 1990s as people uploaded digital pics to the Web primarily so they could have them printed. Flickr emerged in 2004 and was acquired by **Yahoo!** the following year, giving serious photographers a place to publish and show off high-resolution images. Other sites such as **Google**'s Picasa, **Myspace**'s Photobucket, and more recently **Facebook** have each taken a turn at the head of the pack.

Now the digerati are showering attention on a new photo service-cum-social network for the iPhone called **Instagram**, which in four months has managed to attract more than 1.75 million users who are uploading 290,000 photos a day.

The software—accounts are free of charge—allows members to snap pictures with their phones and add visual effects that give images the classic look of photographs captured on traditional film and developed with chemicals. Then users can post their shots to their Instagram accounts or to social networks such as Facebook and **Twitter**. They can also comment on other people's pictures and browse collections of prolific photographers. "You post, and a community gives you instant feedback," says Scott Beale, an Instagram user and founder of Web hosting company Laughing Squid. "It's a quick way of seeing what everyone is up to with minimal effort."

Instagram user Snoop Dogg has 2,000 followers and has posted 14 pictures, mostly of himself

Instagram represents a new kind of Web startup: one whose skyrocketing popularity, thanks to platforms such as **Apple**'s App Store, has largely preceded its evolution into a real company with accouterments like financing, office space, and a permanent Web address. Despite its rapid growth, Instagram has all of four employees; its twentysomething co-founders, Kevin Systrom and Mike Krieger, work with two colleagues in a former conference room adorned with vintage Polaroid Land cameras in a San Francisco office once home to Twitter. They say they haven't created a single PowerPoint slide explaining their money-making plans (which are hazy, but will apparently involve advertising). And they've only recently purchased the Web address Instagram.com from a cybersquatter in China. (When they launched the service, they used a clunkier Internet address with the country suffix for Armenia: Instagr.am.)

Systrom and Krieger have yet to create a website that mimics the app's functionality or a version for

PHOTOGRAPHS BY ROBYN TWOMEY FOR BLOOMBERG BUSINESSWEEK(4)

phones running Android—so far Instagram has been iPhone-only. That, however, is about to change. On Feb. 2, Instagram announced its first major round of funding: $7 million from Silicon Valley venture capital firm **Benchmark Capital** and a list of high-profile investors including Jack Dorsey, a Twitter founder, and Adam D'Angelo, co-founder of another suddenly fashionable Web service, the question-and-answer site **Quora**. Systrom and Krieger will use the funds to hire engineers, build an Android app, and add features. Instagram "enables people to tell their story through a visual dialogue in a way that feels very intuitive," says Matt Cohler, a partner at Benchmark, who will join Instagram's board and apply lessons learned about fast-growing Web services at a past employer: Facebook.

Systrom, who was a product marketing manager working on Google's Gmail just two years ago, says his creation benefited from luck and good timing. "There's this new wave of folks that are obsessed with mobile phones and obsessed with taking photos of the little but beautiful parts of their day, like sunsets," he says. "People are now sharing their lives as they happen." Also helping Instagram is the emergence of handsets such as the iPhone 4 that take decent photos, and of wireless networks fast and reliable enough that people don't mind uploading pictures as they take them.

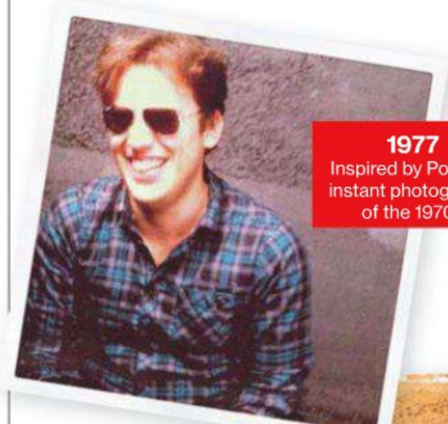
The startup has some influential friends. When Instagram first released its application in October, Dorsey, Twitter's chairman, tweeted about it to his million-plus followers. A few days later, Apple made Instagram the featured app of the day on the App Store, and soon after Apple marketing executive Phil Schiller signed up and started posting photos to the service. Last month the rapper Snoop Dogg became an Instagram user. He has 2,000 followers on the service and has so far posted 14 pictures, mostly of himself.

Instagram will need all the friends it can get. If Twitter introduces its own photo storage and sharing function—that may seem unlikely, given the Dorsey connection, but it's been rapidly adding features as it grows—that would diminish the need for a separate social network for mobile photos.

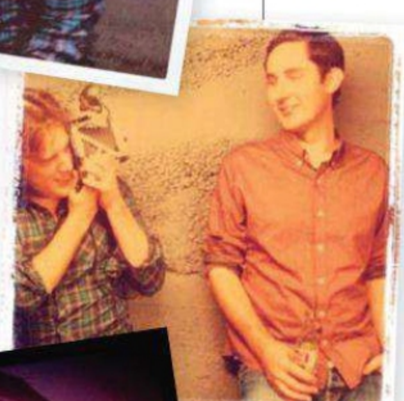
Then there are a few well-funded competitors, including **Mixed Media Labs**, which raised $5 million from the venture capital firm **Andreessen Horowitz** and built an application similar to Instagram called PicPlz. Dalton Caldwell, Mixed Media's chief executive officer, says he believes that he can catch up to Instagram by moving more quickly. PicPlz already has a fully working website, applications for Android as well as the iPhone, and a grand total of eight employees.

By the standards of Silicon Valley's hot mobile startups, that's almost adulthood. —*Brad Stone*

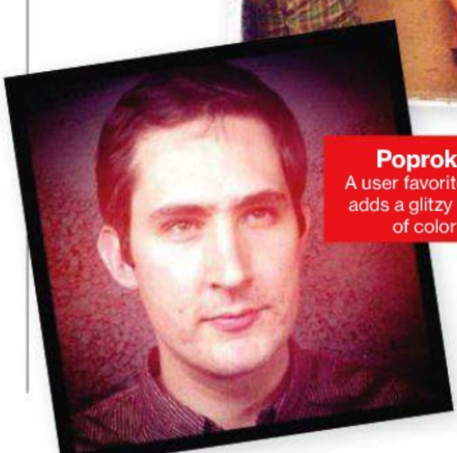
***The bottom line** Four-month-old iPhone app Instagram became a hit before it got real office space. Now it has $7 million in venture capital.*



1977
Inspired by Polaroid instant photography of the 1970s



Lord Kelvin
For a vintage look with hand-painted-looking borders



Poprokit
A user favorite that adds a glitzy burst of color

Alternative Energy

A European Shadow on China's Solar Industry

▸ Mainland producers are boosting output just as Europe cuts subsidies

▸ Capacity "is way ahead of what the market can take"

Last year was a good one for **Yingli Green Energy Holding**. The Chinese company makes photovoltaic solar-power modules, which convert sunlight into electricity. With global demand up, Yingli doubled production capacity and ran its factories "365 days a year, 24/7," says Bryan Li, the company's chief financial officer. "We sold everything." Almost all the modules went to Europe, where governments provide generous subsidies for solar-energy producers.

Yingli plans to expand production another 70 percent this year, and it isn't alone: Other Chinese solar companies, including **Suntech Power Holdings** and **LDK Solar**, plan double-digit production boosts in 2011. "All of the major Chinese producers are engaged in massive, very aggressive capacity-expansion programs," says Paul Leming, an analyst with Soleil Securities in New York.

Their timing might be off. As the Chinese ramp up, austerity-minded governments in Europe are scaling down their solar subsidies. Germany plans to reduce its feed-in tariffs, which guarantee above-market rates to solar power producers, as much as 15 percent by July. France, Spain, the Czech Republic, and other European countries are reducing their support as well. "The amount of capacity being added is way ahead of what the market can take," says Finlay Colville, senior analyst with market research firm Solarbuzz.

Europeans are cutting subsidies because of record-high budget deficits as well as political pushback against policies that some say primarily benefit foreign manufacturers such as Yingli. In France, which cut its feed-in tariffs twice last year, most new solar panels "were made in China with a highly questionable carbon footprint," Environment Minister Nathalie Kosciusko-Morizet told Parliament in Decem-



A solar power plant in China's Gobi desert

ZHANG HEPING/IMAGINECHINA/AP PHOTO

ber. The country's environmental policies must "create jobs in France, not subsidize Chinese industry." That month the French government imposed a three-month freeze on solar projects while it crafts new investment rules.

The new priority for Chinese manufacturers is diversifying their customer base. Today, they're extremely reliant on European demand–more than 60 percent of Yingli's revenues last year, for instance, came from Germany. Suntech aims to reduce its reliance on European sales, which made up 74 percent of total revenue in 2009, by expanding in the U.S. and other markets, says Chief Commercial Officer Andrew Beebe. The company opened a 117,000-square-foot panel plant in Arizona last year and is doubling its U.S. head count to 150 people.

Others are looking at the home market. China's power companies are investing billions in infrastructure so they can transmit electricity across long distances, a prerequisite for moving power from far-off solar and wind farms to energy-hungry cities. Local governments have started providing more support, too. On Jan. 6, **China Sunergy** signed a deal to install 7 megawatts' worth of solar modules on the roof of the Nanjing South Railway Station. On Jan. 10, **CNPV Solar Power** in northeastern China completed a $25 million project that will generate 7 megawatts of solar power. Yingli's Li says the company's domestic sales were "minimal" in 2010 but could grow this year to 10 percent of revenue.

Total Chinese solar demand was only about 400 to 480 megawatts last year. That's more than double the previous year but still well below the size of markets such as Germany's, which bought between 8 and 9 gigawatts' worth of solar modules in 2010. (A gigawatt is a billion watts or 1,000 megawatts.) "It will be a very difficult time," says Jun Ying, an analyst in Beijing with Bloomberg New Energy Finance. Even under the most optimistic scenario, Chinese demand won't top 860 megawatts this year. "If you look at the production capacity" Chinese companies are adding, he says, "that's tiny."

The pressure for consolidation of the overcrowded industry will build, and that may force the government to bail out some companies and prevent a bloodbath, says Soleil Securities' Leming. "Whether we see consolidation or companies hunkering down and borrowing from Chinese state-owned banks is one of the big questions of the year," he says.
—Bruce Einhorn with Tara Patel

The bottom line *Chinese solar-panel manufacturers may be caught with excess capacity as European governments cut subsidies.*

Messaging

You've Got Mail! Except When You Don't

▶ A service outage affects hundreds of thousands of AOL e-mail users

▶ "Horrible things can happen to AOL e-mail and nobody even notices"

If **AOL**'s e-mail system crashes and no one tweets about it, does it make a sound? One day in late January, Kurt Andersen, the novelist and host of public radio show *Studio 360*, tried to check his AOL e-mail account. He was redirected to an error page. Curious whether the problem was widespread, he jumped on **Twitter**, the micromessaging service that has become a soapbox for stranded travelers, disappointed gadget buyers, and other angry consumers. Andersen typed "AOL" into the social media site's search engine. Radio silence.

Andersen was far from alone. AOL was actually in the midst of a severe e-mail service disruption affecting hundreds of thousands of users. Yet the forums that typically fill up with breathless tirades during even the slightest Internet-related glitch were quiet. Tech blogs largely ignored the subject. **Facebook** did not rage. Twitter

Can Whitney back up her predictions? page 51 ▶

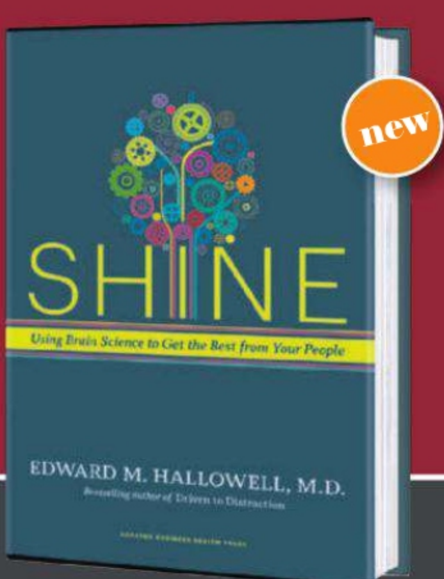


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barely stirred.

The collective yawn was a reminder of just how far out of favor AOL's e-mail service has fallen, particularly among tech-savvy consumers.

"It's become so out of fashion that horrible, horrible things can happen to AOL e-mail and nobody even notices," says Rob Beschizza, the managing editor of Boing Boing, a popular technology and culture blog that made no mention of the meltdown. Danny Shea, senior media editor at the Huffington Post, says that outages on popular services quickly earn their own hashtag—a way to mark tweets relating to a specific event—and a spot on Twitter's list of popular topics. "If it were Gmail, the #GmailFail hashtag would be trending immediately," says Shea.

The service problems began on Jan. 24, when a maintenance procedure went haywire. That day, thousands of users found that their mailboxes were mysteriously incomplete. Parts of some e-mails, folders, and contact lists were suddenly AWOL from AOL's servers. According to a company spokesperson, the failure affected roughly 1 percent of the e-mail service's users.

AOL executives quickly set up a support website and claim to have now fixed more than 99 percent of the accounts affected. "We're glad we were able to recover everything reasonably quickly," says Brad Garlinghouse, AOL's president for consumer applications. Nonetheless, frustrated users continued to post complaints on the support site on Feb. 2. Many vowed to leave AOL for **Google**'s e-mail service, Gmail.

They wouldn't be alone. AOL, which was once the dominant e-mail provider in the U.S., is now the fourth-most popular service, according to comScore, with 25.2 million unique visitors in December 2010, trailing behind **Yahoo!** (93.9 million), Gmail (51.2 million), and Hotmail (45.7 million). The site continues to shrink. Since December 2009, AOL has suffered a 19.5 percent drop in unique visitors.

"When you see somebody who has an AOL e-mail address, you think, 'haven't you heard of Gmail or Yahoo or other Web-based e-mail?' " says Daniel Sieberg, a technology reporter for CBS News, ABC News, and MSNBC. "You think, 'Please, come into the 21st century.' "

"There's an echo chamber in the Twitterverse and a certain arrogance that is sometimes associated with the tech elite," says Garlinghouse. "There are 25 million very active, very happy users of AOL mail. That's something we're proud of." AOL is putting the finishing touches on Project Phoenix, a major overhaul of the company's e-mail system due to be unveiled in the next few months. "We're absolutely aiming to reinvent the inbox," says Garlinghouse.

In the meantime, some AOL e-mail users continue to embrace their old-timey accounts, service disruptions and social stigma be damned. "It's like driving an Edsel or some weird old thing—there's some appeal to it," says Andersen. —*Felix Gillette*

The bottom line *AOL is overhauling its e-mail service, which is so out of vogue that a January disruption went largely unnoticed.*

Cybersecurity

Is WikiLeaks Hacking For Secrets?

▶ A security company says the site is actively hunting for classified data

▶ WikiLeaks may be "doing searches [itself] on file-sharing networks"

In April 2009 the whistle-blower website WikiLeaks published a secret U.S. military document detailing technological capabilities of the U.S. Navy's Pacific Missile Range Facility on Kauai. In an online post explaining how it obtained the information, WikiLeaks indicated only that it came from "a source." It was another coup for WikiLeaks and its founder, Julian Assange, who describes the far-flung organization—it has no fixed domicile—as a secure digital drop box for disaffected insiders. He has repeatedly said WikiLeaks doesn't actively obtain classified documents but rather provides a platform for others who have confidential information to reveal for the public good.

Except that WikiLeaks, according to Internet security company **Tiversa**, appears to have hunted down that military

document itself. Tiversa says the group may have exploited a feature of file-sharing applications such as LimeWire and Kazaa that are often used to swap pirated copies of movies and music for free. If, for example, a Pentagon employee were to log on to such a peer-to-peer network (an array of disparate computers with no central hub) to download a movie, he could possibly expose every last e-mail and spreadsheet on his PC to prying eyes. That's because some peer-to-peer, or P2P, applications may scan users' hard drives for shareable files. Not turning that feature off, or specifying which parts of the hard drive may be searched, leaves the door wide open.

In the missile-range case, Tiversa's systems noticed unusual activity coming from a cluster of computers in Sweden, where until December WikiLeaks had some of its key servers. The cluster was furiously searching P2P networks around the world. It hit pay dirt in the form of a file blandly labeled BPL_HI.pdf, available for download from a computer in Hawaii. The Swedish computers downloaded the document, and two months later it was posted on WikiLeaks.

Executives at Tiversa, which is hired by governments and corporations to use the same loophole to find exposed documents and figure out who might be accessing them, say the Hawaii incident wasn't an isolated case. Its technology has detected the mysterious Swedish computers downloading gigabytes of data, much of which soon appeared on WikiLeaks. "WikiLeaks is doing searches themselves on file-sharing networks," says Robert Boback, Tiversa's chief executive officer. "It would be highly unlikely that someone else from Sweden is issuing those same types of searches resulting in that same type of information." A spokesman for WikiLeaks declined to discuss the sources of its secrets or its policy for verifying information it receives. Mark Stephens, WikiLeaks's London attorney, called the claim "completely false in every regard."

Dozens of P2P networks sprang up in the wake of Napster a decade ago. Teenagers use them to get Justin Bieber songs; grown-ups download episodes of *Mad Men*. The networks are especially popular with soldiers in Iraq and Afghanistan, who use them to swap music and porn. Boback says it's an open secret among researchers, financial fraudsters, and intelligence agencies that many of these networks are rich sources of confidential documents the networks' users accidently share—pirates can easily be pirated, as it were. According to Tiversa, in 2009 a Maryland defense contractor got on a P2P network and exposed the designs for Marine One, the Presidential helicopter; that data wound up on a computer in Iran. To sift through one network, all an intruder needs is a basic understanding of P2P, says Boback. To conduct a massive search of networks around the world, huge amounts of computing horsepower and bandwidth are required.



FROM TOP: JIN LEE/BLOOMBERG; ALASTAIR GRANT/AP PHOTO

Tiversa has plenty of both. In a secure room at the company's headquarters in Cranberry Township, Pa., banks of servers create a minute-by-minute map of what is effectively a global treasure trove of secrets. In a brief demonstration of what's out there for the taking, a Tiversa analyst taps a few keys, and up pops the cell phone number of actress Lucy Liu along with the pseudonym she uses to check into hotels—attached to a production company document clearly labeled "not to be made public." There are several draft chapters of a book by white supremacist David Duke, as well as a spreadsheet of all the donors to his cause. Assange has told interviewers that his group has damaging information on pharmaceutical, energy, and financial companies; Boback confirms that confidential corporate documents are readily accessible.

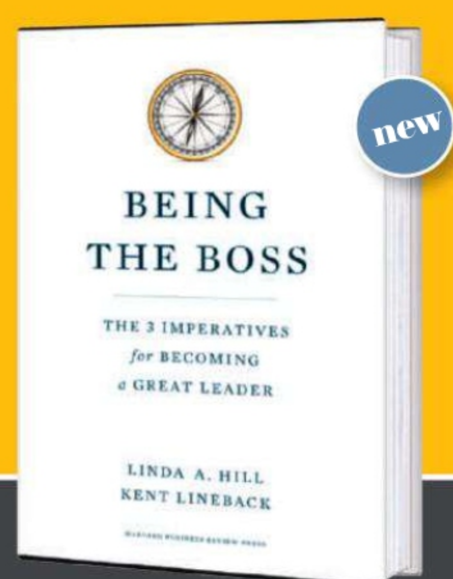
In November 2009, WikiLeaks published a spreadsheet detailing potential terrorist targets in Fresno County, Calif., compiled by state and federal security officials. The document noted locations of bomb-grade fertilizer caches, large gasoline and propane reserves, and the coordinates of key military and law enforcement sites and their functions. Tiversa found the spreadsheet was inadvertently exposed by a California state employee using the FrostWire peer-to-peer network in August 2008, more than a year before WikiLeaks posted it. Army intelli-

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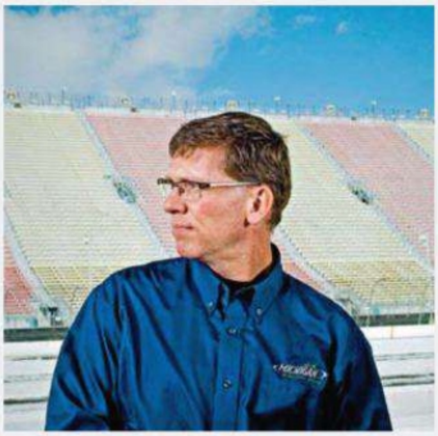
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Innovator

Roger Curtis



The Michigan International Speedway is idle most of the year. Its chief wants to make it a testing ground for next-generation vehicles

In August 2006, Roger Curtis was two months into his job as head of the Michigan International Speedway and sitting in a helicopter hovering over the racetrack's parking lot. Nascar fans trying to exit had created a five-hour traffic jam that snarled below him. Curtis worked with state transportation officials to add lanes and change the flow of traffic, ultimately cutting the delay to 1.5 hours in time for the following race season.

Curtis, 44, now wants to turn the speedway into a test bed for transport innovation. The next generation of roads and automobiles will be more intelligent, talking to each other and wireless-data networks to help keep people safe and traffic flowing smoothly. A smart intersection, for instance, might be able to detect a vehicle about to run a red light and warn other cars, preventing collisions.

Such smart systems must work with all kinds of autos from different manufacturers, so Curtis says they'll need a neutral site for planning and testing, and that the 1,400-acre speedway is ideal. The site has 7.8 miles of roadways that go mostly unused outside Nascar season, 26 miles of fiber-optic cable to pipe in high-speed Net, and Wi-Fi. Curtis is also developing movable intersections so researchers can simulate various driving conditions, including rural highways and busy urban grids.

The site in Brooklyn, Mich., about 100 miles west of Detroit, has already hosted a handful of tests, giving the speedway a new income source. The U.S. Army Tank Automotive Research, Development, and Engineering Center conducted a four-day experiment using intelligent systems to guide convoys. Five carmakers have looked over the property, and two may be back this year to test smart systems, says Curtis, though he wouldn't identify the companies. The racetrack also has hosted emissions-related research, including final tests for the Progressive Automotive XPrize, which awarded $10 million to teams that built a vehicle capable of achieving 100 miles per gallon. "We're on the map now," says Curtis.

Richard Wallace, a director at the Ann Arbor (Mich.) Center for Automotive Research who specializes in intelligent vehicle communications, says that "having a test facility like this is very valuable. These systems all have to be able to talk to each other."

Curtis says his position in auto innovation is an unlikely one. For most of his 18 years in motor sports administration, he focused on marketing, which is what the Terre Haute native studied at Indiana State University. He hopes opening the speedway to researchers is one way to persuade auto companies to keep their research and development spending in Michigan, his adopted state. "When the time comes for the floodgate for really testing connected vehicles and connected roadways, we'd like to be sure that it's done right here." —*Jeff Green*

First Challenge ▶ Unsnarling a five-hour traffic jam

Selling Point ▶ The speedway has 7.8 miles of roads and strong Wi-Fi

Experiment ▶ The U.S. Army's tank researchers tested intelligent convoys

Technology

gence documents posted by WikiLeaks in 2009 that included reports on Taliban leaders and their movements were accidentally leaked by a P2P user eight months earlier. For a list of every **Chevron** property in the U.S. and Canada, the gap was two months–from March to May 2009, Tiversa says.

Could those Swedish computers belong to other hackers, who then deposit the documents in WikiLeaks's drop box? Highly unlikely, says Boback. "There are not that many whistle-blowers in the world to get you millions of documents," he says. "However, if you are getting them yourselves, that information is out there and available."

A federal grand jury in Virginia is examining WikiLeaks's publication of U.S. diplomatic cables, a case unrelated to file sharing. The possibility that the site is systematically ransacking computers may offer prosecutors an alternate path to get the group and its founder into a U.S. courtroom. "There is a difference between being given information that may have been obtained in violation of some agreement or law, vs. the media itself violating the law or an agreement in order to obtain information," says Sandra Baron, the executive director of the Media Law Resource Center in New York. "The media is not allowed to steal."

The case law is murky. A federal prosecutor in Seattle successfully argued two cases recently involving individuals who retrieved financial information through LimeWire "in excess of authorization." (LimeWire's parent company ceased operations in December, although the network lives on.) Other federal courts have found that law enforcement searches of private computers through LimeWire and other networks were perfectly legal.

More likely is that WikiLeaks's legions of fans among professional journalists will have to rethink their view of WikiLeaks and its founder as the Second Coming of Woodward and Bernstein. That duo famously cultivated Deep Throat as a source for articles that exposed the Watergate scandal. "This," says Mark Jurkowitz, associate director for the Project for Excellence in Journalism, "would be more akin to wiretapping Deep Throat's phone." —*Michael Riley*

The bottom line *WikiLeaks, which says it's a passive drop box for whistle-blowers, is accused of searching hard drives for classified documents.*

PHOTOGRAPH BY GREG RUFFING FOR BLOOMBERG BUSINESSWEEK

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▶ Bid & Ask: A mega-merger in real estate; an Ivory Coast default 56 ● Edited by Eric Gelman

Markets&Finance

Whitney's Muni Forecast Is Short on Specifics

▶ **While standing by her gloomy call, she says "quantifying is a guesstimate at this point"**

▶ **"She's trying to shock the market into a panic mode"**

"There's not a doubt in my mind that you will see a spate of municipal-bond defaults," the banking analyst Meredith Whitney, nodding her head, said on a Dec. 19 segment of CBS's *60 Minutes*.

"How many is a spate?" correspondent Steve Kroft asked.

"You could see 50 sizable defaults, 50 to 100 sizable defaults, more," said Whitney, 41, who made her name covering bank stocks. "This will amount to hundreds of billions of dollars' worth of defaults."

Those two sentences set off a month of fireworks in the almost $3 trillion muni market. California Treasurer Bill Lockyer called the prediction "apocalyptic arm-waving." The National League of Cities' research director cited her "stunning lack of understanding." **Pimco**'s William H. Gross, who runs the world's biggest bond fund, simply said he doesn't subscribe to the "theory."

James A. Bianco, the president of Bianco Research in Chicago, compares the attacks on Whitney with the fury directed at New York University economist Nouriel Roubini, who in 2006 predicted the financial crisis. "Everybody was lining up to tell us why Roubini was wrong, and he wasn't," Bianco says.

Meanwhile, investors pulled about $4 billion from municipal-bond mutual funds in the week ended Jan. 19, the most since Lipper U.S. Fund Flows started compiling the data in 1992. Investors have withdrawn money from muni funds for 11 straight weeks, as of Jan. 26, according to Lipper, taking out $22.5 billion. Returns on municipal securities fell the most in 16 years in the fourth quarter of 2010, according to the Merrill Lynch Municipal Master Index. The cost for AAA-rated issuers to borrow for 30 years climbed by almost a third, to 5.09 percent on Jan. 17, from 3.85 percent on Nov. 1.

"We've got terrified clients who call constantly and want reassurance because Meredith said there's going to be hundreds of billions of dollars of defaults," says David R. Kotok, chief investment officer at **Cumberland Advisors** in Vineland, N.J., which manages more than $1.5 billion.

While Whitney is not retreating from her prediction, she says she doesn't have specific numbers to back it up. "Quantifying is a guesstimate at this point," she told Bloomberg on Jan. 30. "I was giving an approximation of a magnitude that will bear out to be correct."

Whitney, a Brown graduate who worked at **Oppenheimer & Co.** before setting out on her own, is not the first to warn of trouble in the muni market. Richard Ravitch, then New York's lieutenant governor, cautioned about "cracks in the municipal-bond market" in 2009. Yet Whitney, who was a contributor on **Fox News Network** from 2003 to 2007, has become a media luminary, and her views generate a lot of attention.

On Sept. 28, **Meredith Whitney Advisory Group**, the New York firm she started after correctly predicting Citigroup's 2008 dividend cut, produced a report for clients called "Tragedy of the Commons." The report



DANIEL ACKER/BLOOMBERG

does not say anything about sizable defaults amounting to hundreds of billions of dollars. Nor does a long addendum that profiles 15 states, according to a person who has seen it. Asked why not, Whitney says: "There are fifth-derivative dimensions that I don't think I need to spell out to my clients."

On page 2, the report says, "While we do not believe defaults on debt at the state level pose a significant risk, we believe there will invariably be defaults at the local level," and does not elaborate. Whitney's thesis is that struggling states will cut aid to local governments. The report adds that "states will default in a different way. We believe states have and will continue to default on social contracts in the form of reduced spending" on programs, including education and transportation.

$2.7bn

The dollar value of defaults in the municipal bond market last year

On Nov. 16, in a video interview with the *Financial Times*, she said defaults would spark "panic in the muni markets." In a Dec. 21 appearance on CNBC, she said states and cities would have to make severe spending cuts and used the phrase "social unrest" twice. Whitney says she doesn't remember using the word "panic" and that the phrase "social unrest" now "seems very loaded" because of the events in Egypt.

"She's trying to shock the market into a panic mode," says Thomas G. Doe, chief executive officer of Municipal Market Advisors, a research company in Concord, Mass. "All she has done is reiterate her headline, but there's no substance."

Whitney's comments aren't the only factor behind muni price declines, says George Friedlander, **Citigroup**'s municipal strategist. In November, when the Federal Reserve started buying U.S. government debt under its quantitative easing policy, the yields on Treasury securities rose, making them more attractive relative to muni bonds. In addition, the market was flooded by states and cities rushing to sell federally subsidized bonds under the Build America program before a yearend deadline, depressing prices.

On Nov. 16, a Fitch Ratings report said that even if there are more defaults than in recent years, they will "continue to be isolated situations." It notes that states and cities can raise taxes and adds that "debt service is a relatively small part of most budgets so not paying it does not do much to solve fiscal problems (particularly as compared to the costs of such an action)."

Municipalities rarely fail to make their principal and interest payments to investors, according to Moody's Investors Service, which counted 54 bond defaults over a 39-year period in a report last year on securities it rates. There were $2.7 billion of municipal defaults last year, according to Richard Lehmann, the Miami Lakes (Fla.) publisher of *Distressed Debt Securities Newsletter*. That was down from a record $8.5 billion in 2008. Lehmann's numbers include securities that were issued without ratings.

Whitney's warnings come as she is trying to build a bond-rating business. On Nov. 10, Whitney met with U.S. Securities and Exchange Commission Chairman Mary L. Schapiro to discuss her company's planned application to be approved as a "nationally recognized statistical rating organization" that would compete with **Standard & Poor's, Moody's**, and the eight other accredited companies. Whitney says she expects to hire "hundreds of people" to cover municipal securities. She would also rate corporate debt and structured products.

Asked how her rating service would distinguish itself from rivals, she says she has "an untarnished track record." Bloomberg News reported in October that about two-thirds of her stock picks since starting her company in 2009 had fared worse than market indexes. **Visa** fell 14 percent after she called it her "single best buy," and **Capital One Financial** tripled after she urged clients to sell. "Those are not fundamental calls," she says. What really matters are her analyses of major trends in the industry, she says. "You want to play, let's play," Whitney says, handing over a stack of reports dated from 2001 to 2009, on topics from **Goldman Sachs** to consumer spending.

The criticism of her default predictions "doesn't feel good," she says. "What are you going to do?" Whitney says she believes her views put her in "great company," mentioning former President Bill Clinton, who told CNBC on Jan. 27 that he suspects that in the next 60 to 90 days people across America will be trying to figure out ways to restructure local debt. A day earlier, billionaire investor George Soros told the network that state and local finance will provide "the drama of the next year or so."

Whitney does not expect to wait long to be proved right. "I don't think July's going to roll around without defaults," she says. And if she's wrong? She says she'll "adjust." —*Max Abelson and Michael McDonald*

The bottom line *While she still sees widespread muni bond defaults, Whitney won't offer specific numbers backing her* 60 Minutes *predictions.*

Quoted

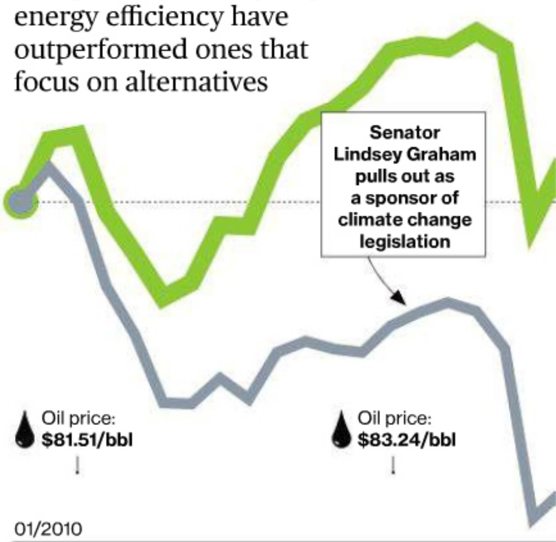
"Hubris is the biggest risk in the banking system. It is the most dangerous emotion to run a financial institution. What went wrong is, we started to believe our own propaganda and created a culture where people didn't push back."
— Edmund Clark, chief executive of Toronto-Dominion Bank

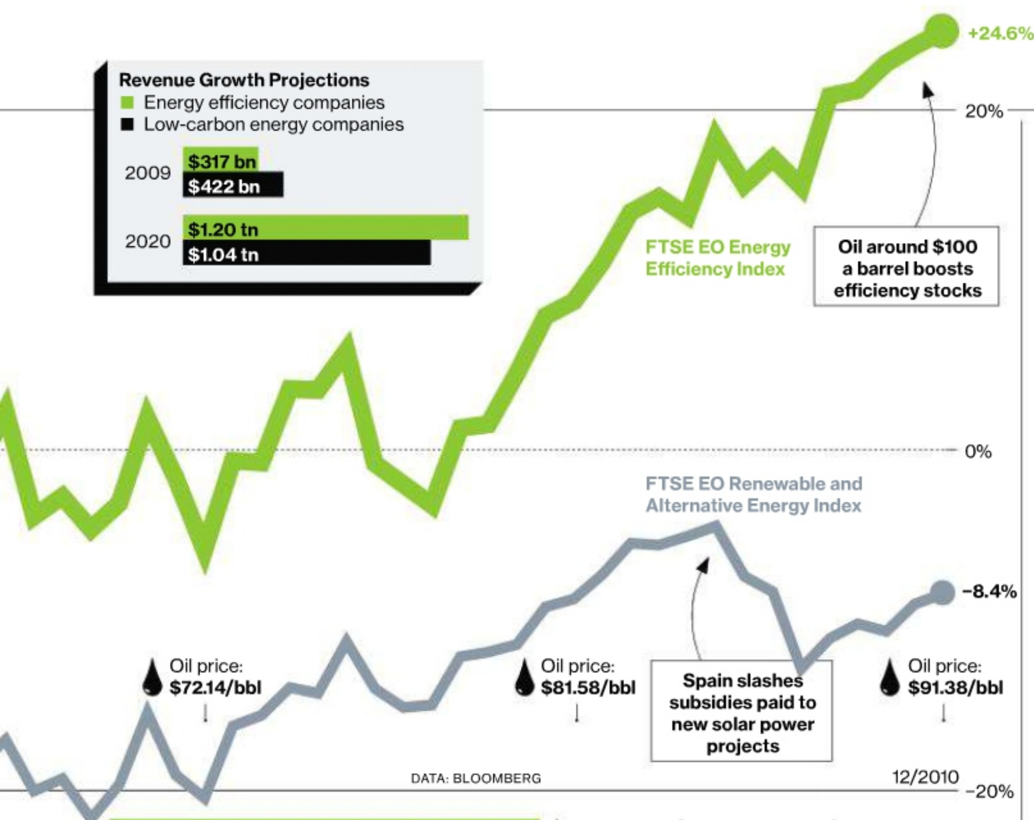


Energy

Woes for Renewables

Companies that help improve energy efficiency have outperformed ones that focus on alternatives





Investing

A Bright Outlook for Energy Efficiency Plays

▶ Companies could see revenues gain 13 percent a year, says HSBC

▶ The industry may end up "benefiting significantly" from high oil prices

When it comes to green investing and profiting from efforts to curb carbon emissions, stocks of companies that make light-emitting diodes (LEDs) and insulation offer better prospects than wind and solar power. "Clean energy investments are riskier today, but energy efficiency is a no-brainer," says Nino Tronchetti Provera, chief executive officer of Milan's **Ambienta SGR**, a private equity investor that manages a $294 million environmental fund.

Here's why: European countries have been cutting clean energy subsidies to slash budget deficits, and the U.S. failed last year to pass federal energy legislation to cut carbon emissions and boost alternative power. Increasingly, countries are turning to energy efficiency for "quick wins" in cutting power use and carbon emissions, says Ronan O'Regan, director of renewables at global accounting and consulting firm PricewaterhouseCoopers. "Payback on energy efficiency is anything up to 12 to 24 months," he says. "With renewable technologies, even with a subsidy you're talking about maybe 7 to 10 years."

Global revenue for energy efficiency companies probably will expand 13 percent a year through 2020, vs. 8.6 percent for wind, solar, and nuclear power providers, says Robert Clover, head of alternative energy equities in London at HSBC Holdings. Given the fiscal pressures on many governments these days, Clover says the current regulatory trends favor energy efficiency rather than low-carbon energy.

Efficiency measures include improvements to cars and trains that cut fuel use, lighting units such as LEDs that use less electricity, equipment that makes factories more productive, and smart-grid technology that uses computerized meters to regulate power. Companies most active in this market tend to be diversified giants such as **Siemens**, **General Electric**, and **ABB**, according to Tom Rowlands-Rees, an analyst at Bloomberg New Energy Finance. Companies with market caps above $1 billion that get more than half of their revenue from energy efficiency include **Cree**, a Durham (N.C.) maker of lighting components, and insulation companies **Rockwool International** in Hedehusene, Demark, and **Kingspan Group** in Cavan, Ireland, he says.

HSBC has "overweight" ratings on LED makers **Epistar** of Taiwan and **Seoul Semiconductor,** which may benefit from rules phasing out incandescent bulbs. HSBC analysts also like Germany's **Vossloh**, a maker of components for railroads and trains, and France's **Schneider Electric**, which makes power distribution equipment. Siemens is favored for its energy management systems for buildings, transportation, and factories. In a Jan. 28 note, HSBC said power transmission company **Jyoti Structures** and electrical equipment maker **Compton Greaves**, both based in Mumbai, may benefit from the predicted 16 percent annual growth in India's energy efficiency market through 2020.

The momentum in energy efficient stocks may continue with the price of oil about $100 a barrel, says Impax Asset Management Group CEO Ian Simm. The London company has £1.8 billion of assets ($2.9 billion) under management and invests in environmental sectors that include renewables, efficiency, and water. "We see energy efficiency as benefiting significantly from high and probably rising oil prices around the world, and we still see a downside in renewable energy," Simm says.
—*Alex Morales and Louise Downing*

The bottom line *Stocks of companies aiding energy efficiency are set to outperform clean energy stocks, which carry higher political risk.*

Private Equity

The Debt-Heavy Meet The Yield-Hungry

▶ Even highly leveraged companies can borrow to refinance debt

▶ "You have a lot of money searching for yield"

In February 2009, Wall Street was betting that some highly indebted companies taken private by the likes of **Blackstone Group**, **Kohlberg Kravis Roberts**, and other buyout firms weren't going to make it. Credit-default swaps (CDS)–instruments that pay off when borrowers can't meet their obligations–were priced at a level that implied a 99.8 percent chance of debt default for **Clear**

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Channel Communications, **Univision Communications**, **Freescale Semiconductor**, and the former Harrah's Entertainment (now **Caesars Entertainment**). The thinking was that with credit markets frozen, those companies would not be able to borrow the money they needed to refinance loans and bonds as they came due.

Two years later, as the economy recovers and access to debt markets opens for even the least creditworthy companies, the story is different. CDS prices on those companies now imply a 47 percent chance of a collapse, according to data compiled by Bloomberg as of Jan 31. The companies' bonds have shown similar improvement: Caesars bonds now trade at 97¢ per dollar of face value, up from 13¢ two years ago.

What happened? As the Federal Reserve holds benchmark interest rates near zero to stimulate the economy, the companies are finding that investors are increasingly willing to lend them money to refinance their buyout-related loans and bonds. "You have a lot of money searching for yield, and when that happens a lot of folks can get money regardless of the situation of their balance sheet and income statement," says Lon Erickson, a money manager who helps

20.4

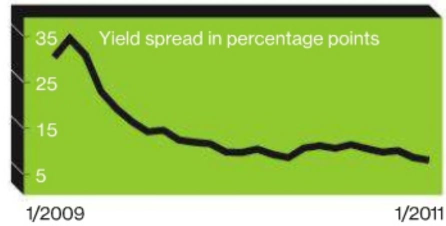
PERCENT

The portion of homeowners who were at least 60 days late on their mortgage payments a year after having the loans modified under a federal program to help reduce foreclosures

DATA: TREASURY DEPT.

Growing Faith in Junk

The gap between yields on low-rated junk bonds and Treasuries has narrowed



DATA: BLOOMBERG

oversee $9 billion of fixed-income assets for **Thornburg Investment Management** in Santa Fe, N.M.

Realogy, a real estate company owned by Leon Black's **Apollo Global Management**, sold $700 million of bonds yielding 7.875% in January, contributing to the $5.2 billion of sales for the month by companies in Moody's Investor Services' lowest tier of credit ratings. For all of 2010, bond sales by low-rated companies totaled $43.7 billion, Bloomberg data show, triple the $14.1 billion issued in 2009. Investors' appetite for junk bonds has led to higher prices—and lower yields. On the bottom tier of junk debt, yields fell to 8.12 percentage points above Treasuries in the week ended Jan. 28, the smallest gap since November 2007, according to Bank of America Merrill Lynch index data. The spread was as high as 44.3 percentage points in December 2008 in the aftermath of Lehman Brothers' bankruptcy.

Some leveraged buyouts still face challenges to refinance debt, including **Energy Future Holdings**, the largest buyout in history. Natural gas prices slumped following KKR's and **TPG Capital**'s $43.2 billion takeover of the company, then known as TXU, in 2007. CDS prices now imply a 79.4 percent chance of default by Energy Future within five years, figures from market data company CMA show. Lisa Singleton, a spokeswoman for Dallas-based Energy Future, declined to comment.

One reason investors are more confident is that the pace of defaults is slowing. In December the rate of defaults by speculative-grade companies over the previous 12 months was 3.27 percent, down from 11.1 percent at the end of 2009, according to a Jan. 25 report by Standard & Poor's. The rating company predicts that the rate will fall to 2.4 percent by September.

The coming global youthquake page 58 ▶



Bond investors are also speculating that LBOs will benefit from the stock-market rally. More than half of the initial public offerings planned in the U.S. for this year were from private equity firms as of the start of this year, Bloomberg data show. When they sell stock to the public, companies are able to use the proceeds to retire debt.

Nielsen Holdings, the television-rating company owned by Blackstone, **Carlyle Group**, KKR, and **Thomas H. Lee Partners**, raised $1.89 billion on Jan. 26 in the biggest private equity-backed U.S. IPO. "You may see a stronger IPO market this year than you've seen in the last couple of years," says Hans Mikkelsen, an analyst at Bank of America. Issuing equity is "really a prerequisite for a lot of these companies to improve their capital structure."

With previous buyouts back from the dead, the world's largest private equity funds are planning a new round of takeovers. KKR is seeking to raise $8 billion to $10 billion for a new fund. In an interview with Bloomberg TV at the World Economic Forum in Davos, Switzerland, Blackstone co-founder Stephen A. Schwarzman said that there is capital to fund leveraged buyouts of as much as $10 billion as debt becomes more available.

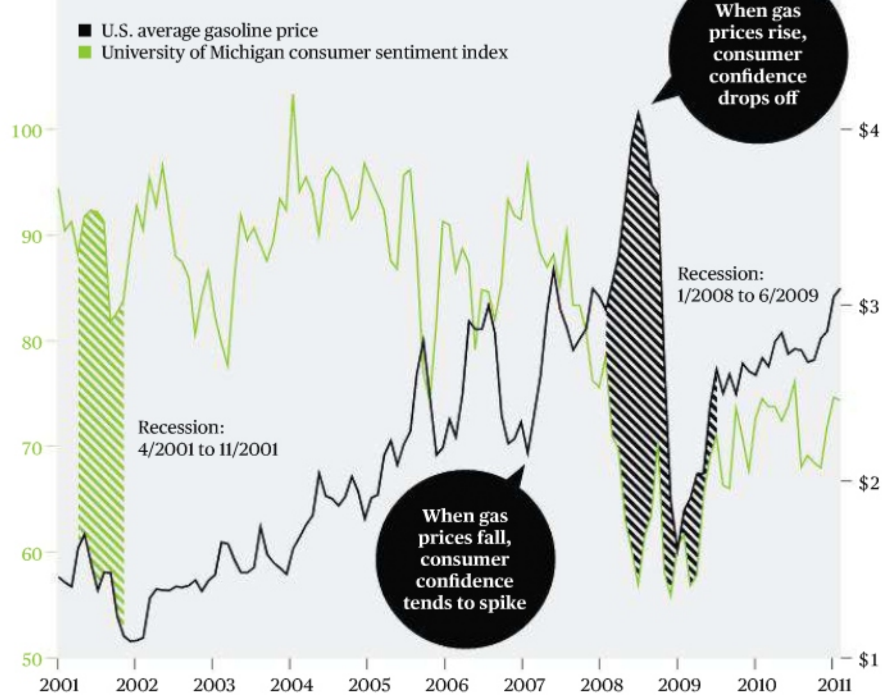
"We're all absolutely shocked at how fast leverage snapped back from where we were, say, two years ago," says William G. Welnhofer, a managing director at **Robert W. Baird & Co.** in Chicago. "I don't think anyone who's honest would have expected such a move."
—*Sapna Maheshwari and Mary Childs*

The bottom line *Investors willing to go out on a limb for higher yields are helping heavily indebted companies refinance their loans and bonds.*

U.S. Economy

Deflated at the Pump

Rising gasoline prices may be sapping the strength of the U.S. recovery. James D. Hamilton, a professor at the University of California, San Diego, has found that for every increase of 10¢ a gallon at the pump, consumer confidence falls by half a percentage point. —*David Wilson*



DATA: U.S. DEPT. OF ENERGY, UNIVERSITY OF MICHIGAN

Asian Markets

Chinese Stocks Look Ready to Rally

▶ The MSCI China Index hit a record low compared with Hong Kong

▶ "Stocks look very cheap, but no one wants to be the first to get in"

Chinese stock valuations have tumbled to a record low compared with those in Hong Kong, a sign to investors that mainland equities are poised to rally even as the government cracks down on inflation. The MSCI China Index began its retreat on Nov. 8, after the country's policymakers stepped up efforts to reduce inflation by raising interest rates on Oct. 19. Its ensuing 9.4 percent slump leaves the index trading at 11.6 times estimated profit for 2011, data compiled by Bloomberg show. The MSCI Hong Kong Index, meanwhile, rallied 26 percent between July and December, beating China shares by the most in nine years and pushing its valuation to 17.5 times earnings, the highest ever compared with shares on the mainland.

Prudential Financial and **USAA Investment Management** say the gap will close because China's economic growth may average 9.6 percent over the next two years, double the International Monetary Fund's forecasted average global growth of 4.4 percent for 2010 and 4.5 percent for 2011. Premium valuations in Hong Kong stocks, which are the route into China for most investors, signal that seven government-ordered increases in bank reserves and two interest rate boosts since the start of 2010 won't derail growth, they say. "Things will be all right even as China takes steps to tighten," says John Praveen, the Newark (N.J.)-based chief investment strategist at Prudential International Investments Advisers. "Chinese growth will still be good."

While the pace of China's growth will slow in the next five years, its economy need not contract, says Aaron Gurwitz, chief investment officer at Barclays Wealth and a bull on Asian stocks. The global recovery is boosting demand for Chinese goods even as the nation takes steps to cool expansion in what likely became the world's second-

MARTIN BUREAU/AFP/GETTY IMAGES

Markets&Finance

largest economy last year. China's exports to the U.S. totaled $283.3 billion in 2010, according to customs bureau figures released on Jan. 10. Gross domestic product in the U.S. grew at a 3.2 percent annual rate in the fourth quarter, up from 2.6 percent during the previous three months, the Commerce Dept. said on Jan. 28.

The last time Chinese stocks were this cheap relative to Hong Kong's, in June 2004, the MSCI China Index was almost two months into a 3½-year bull market. Index valuations increased fivefold, and the earnings multiple climbed to 31 from 12.5, data compiled by Bloomberg show. At the time, the U.S. Federal Reserve was preparing to raise interest rates from 1 percent, a record low until policymakers cut their target for overnight loans between banks to near zero at the end of 2008.

45%

Investors expecting a financial crisis in China within five years

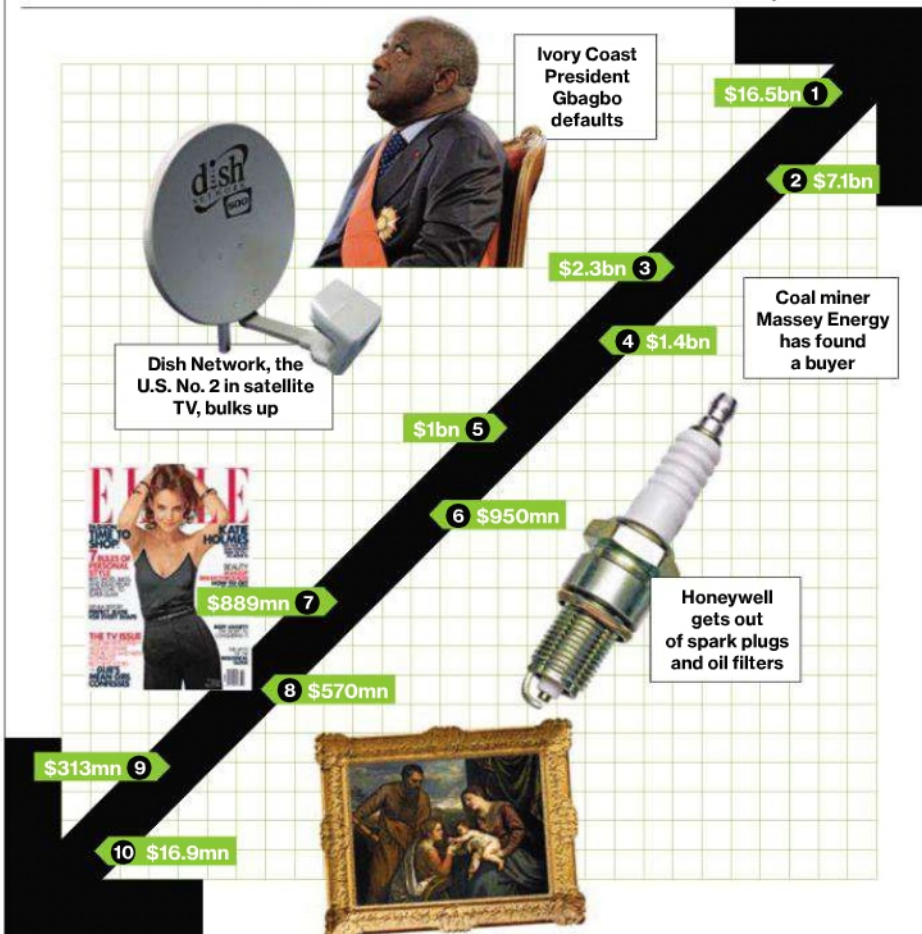
Despite that history, many investors are wary. Global investors are bracing for a financial crisis in China, with 45 percent saying they expect one within five years and another 40 percent anticipating a meltdown after 2016, according to a quarterly Bloomberg Global Poll of 1,000 Bloomberg customers who are investors, traders, or analysts. "Chinese stocks look very cheap," says Terrace Chum, the Hong Kong-based managing director of greater China equities for **Manulife Asset Management**, which oversees $118 billion. "But no one wants to be the first to get in."

Chum won't jump in without a better feel for inflation in China. China's statistics bureau reported consumer prices rose 5.1 percent in November, the fastest pace in 28 months. "The test Chinese policymakers face is probably a little tough," says Madelynn Matlock, who helps oversee $13.8 billion at Huntington Asset Advisers in Cincinnati. "They have to find a way to keep the economy growing without overheating. The good news is they've done a good job so far."
—*Lynn Thomasson and Rita Nazareth*

The bottom line *China stocks are at a record low vs. Hong Kong's. Concerns over a Chinese financial crisis are keeping investors on the sidelines.*

Bid & Ask

by Cristina Lindblad



1 **ProLogis** and **AMB Property**, the two biggest industrial real estate trusts in the U.S., announced a $16.5 billion merger. The combined company will manage some $46 billion in assets.

2 **Massey Energy**, whose Upper Big Branch Mine in West Virginia was the site in April of the worst U.S. coal mining disaster in 40 years, sold itself to Alpha Natural Resources for $7.1 billion.

3 **Ivory Coast** defaulted on $2.3 billion in Eurobonds. The African nation has been in a political stalemate since incumbent President Laurent Gbagbo and his rival Alassane Ouattara both claimed victory in November elections.

4 **Verizon Communications** will pay $1.4 billion for Terremark Worldwide, a Miami company that runs data centers in the U.S., Europe, and Latin America.

5 Satellite TV provider **Dish Network** is buying DBSD North America out of bankruptcy for about $1 billion, to compete better against rival DirecTV.

6 **Honeywell**, based in Morris Township, N.J., is selling its car care division, which makes Fram oil filters and Autolite spark plugs, to New Zealand's Rank Group for $950 million.

7 **Hearst** made an $889 million cash offer for the international magazine portfolio of French publishing group **Lagardère**, which counts the American edition of *Elle* and *Car and Driver* among its titles.

8 China's largest offshore oil producer, **CNOOC**, is paying $570 million for a one-third stake in Chesapeake Energy's Niobrara shale project, which straddles Colorado and Wyoming.

9 **Host Hotels & Resorts** bought the 775-room New York Helmsley Hotel in midtown Manhattan for $313.5 million and plans to turn it into a Westin.

10 A large-scale **Titian** canvas titled *A Sacra Coversazione* fetched $16.9 million at a Sotheby's sale in New York, setting an auction record for the artist. **B**

3: REBECCA BLACKWELL/AP PHOTO; 5: DANIEL ACKER/BLOOMBERG NEWS; 6: IMAGE SOURCE/GETTY IMAGES; 10: FRAME: GRANT FAINT/GETTY IMAGES; PAINTING: SOTHEBY'S/BLOOMBERG

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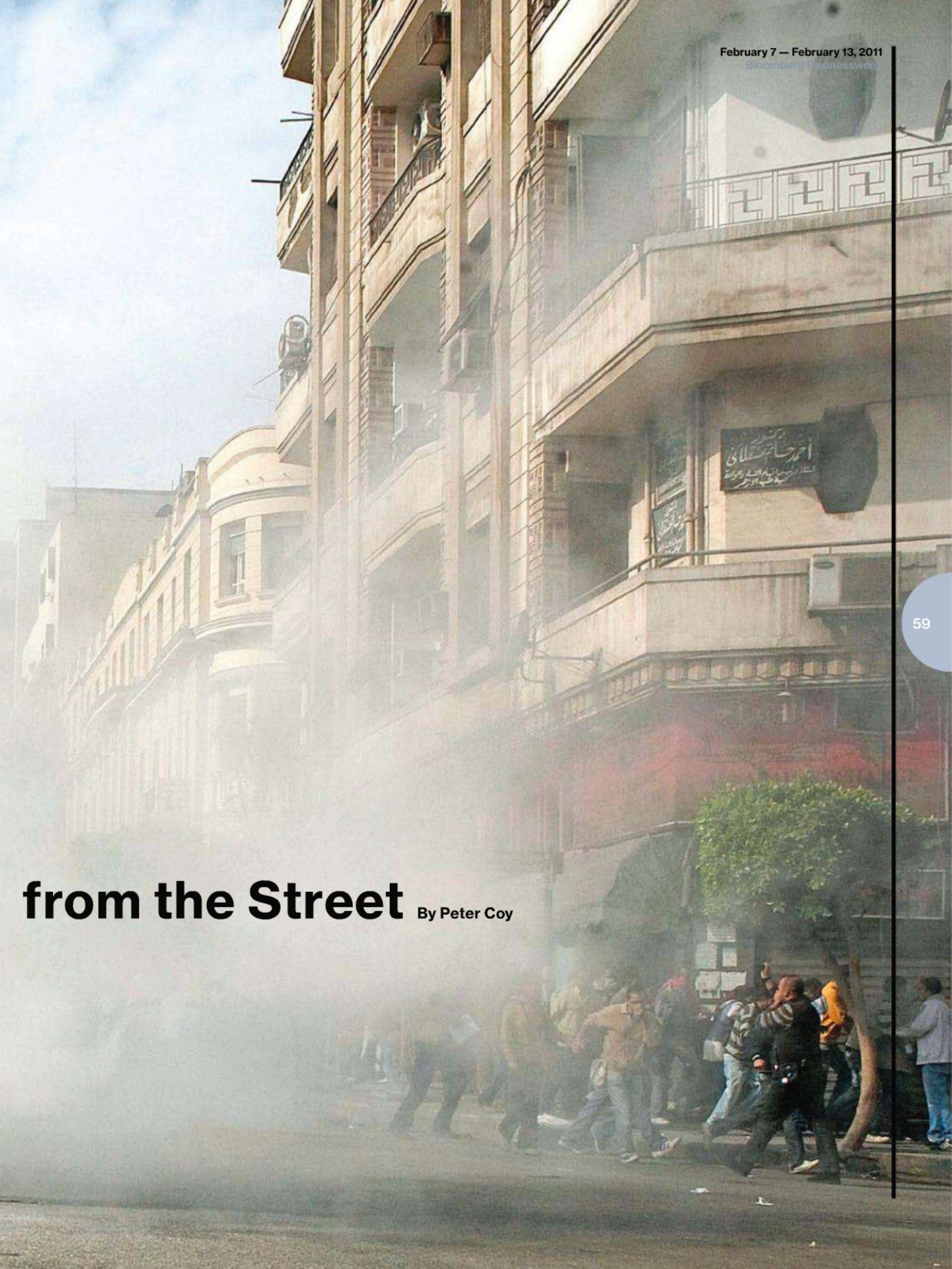
NFV-0652AO (12/10)

Youth unemployment is driving unrest in the Middle East—and hollowing out societies from Europe to the U.S.



A Message

Cairo, Egypt:
A cloud of tear gas drives back antigovernment protesters on Jan. 28



from the Street

By Peter Coy

In Tunisia, the young people who helped bring down a dictator are called *hittistes*—French-Arabic slang for those who lean against the wall. Their counterparts in Egypt, who on Feb. 1 forced President Hosni Mubarak to say he won't seek reelection, are the *shabab atileen,* unemployed youths. The *hittistes* and *shabab* have brothers and sisters across the globe. In Britain, they are NEETs—"not in education, employment, or training." In Japan, they are *freeters:* an amalgam of the English word freelance and the German word *Arbeiter*, or worker. Spaniards call them *mileuristas,* meaning they earn no more than 1,000 euros a month. In the U.S., they're "boomerang" kids who move back home after college because they can't find work. Even fast-growing China, where labor shortages are more common than surpluses, has its "ant tribe"—recent college graduates who crowd together in cheap flats on the fringes of big cities because they can't find well-paying work.

In each of these nations, an economy that can't generate enough jobs to absorb its young people has created a lost generation of the disaffected, unemployed, or underemployed—including growing numbers of recent college graduates for whom the post-crash economy has little to offer. Tunisia's Jasmine Revolution was not the first time these alienated men and women have made themselves heard. Last year, British students outraged by proposed tuition increases—at a moment when a college education is no guarantee of prosperity—attacked the Conservative Party's headquarters in London and pummeled a limousine carrying Prince Charles and his wife, Camilla Bowles. Scuffles with police have repeatedly broken out at student demonstrations across Continental Europe. And last March in Oakland, Calif., students protesting tuition hikes walked onto Interstate 880, shutting it down for an hour in both directions.

More common is the quiet desperation of a generation in "waithood," suspended short of fully employed adulthood. At 26, Sandy Brown of Brooklyn, N.Y., is a college graduate and a mother of two who hasn't worked in seven months. "I used to be a manager at a Duane Reade [drugstore] in Manhattan, but they laid me off. I've looked for work everywhere and I can't find nothing," she says. "It's like I got my diploma for nothing."

While the details differ from one nation to the next, the common element is failure—not just of young people to find a place in society, but of society itself to harness the energy, intelligence, and enthusiasm of the next generation. Here's what makes it extra-worrisome: The world is aging. In many countries the young are being crushed by a gerontocracy of older workers who appear determined to cling to the better jobs as long as possible and then, when they do retire, demand impossibly rich private and public pensions that the younger generation will be forced to shoulder.

In short, the fissure between young and old is deepening. "The older generations have eaten the future of the younger ones," former Italian Prime Minister Giuliano Amato told *Corriere della Sera*. In Britain, Employment Minister Chris Grayling has called chronic unemployment a "ticking time bomb." Jeffrey A. Joerres, chief executive officer of Manpower, a temporary-services firm with offices in 82 countries and territories, adds, "Youth unemployment will clearly be the epidemic of this next decade unless we get on it right away. You can't throw in the towel on this."

The highest rates of youth unemployment are found in the Middle East and North Africa, at roughly 24 percent each, according to the International Labor Organization. Most of the rest of the world is in the high teens—except for South and East Asia, the only regions with single-digit youth unemployment. Young people are nearly three times as likely as adults to be unemployed.

Last year the ILO caught a glimmer of hope. Poring over the data from 56 countries, researchers estimated that the number of unemployed 15- to 24-year-olds in those nations fell in 2010 by about 2 million, to just under 78 million. "At first we thought this was a good thing," says Steven Kapsos, an ILO economist. "It looked like youth were faring better in the labor market. But then what we started to realize was that labor force participation rates were plunging. Young people were just dropping out."

Youth unemployment is tempting to dismiss. The young tend to have fewer obligations, after all, and plenty of time to save for retirement. They have the health and strength to enjoy their leisure. "I spend many hours a day playing soccer with my friends," says Musa Salhi, an 18-year-old Madrid resident who studied to be an electrician but hasn't worked in over a year. Even as fighters on horses and camels galloped through Cairo's Liberation Square on Feb. 2 and the U.N. estimated that 300 people had died in a week of clashes, the world's investors continued to perceive the consequences as largely local. The Standard & Poor's 500-stock index rose 1 percent in the week following the first mass protests on Jan. 25. Crude oil prices rose less than 4 percent over the period.

But the failure to launch has serious consequences for society—as Egypt's Mubarak and Tunisia's overthrown President, Zine al-Abidine Ben Ali, discovered. So did Iranian President Mahmoud Ahmadinejad, who in 2009 dispatched baton-wielding police against youths protesting his disputed reelection. "Educated youth have been in the vanguard of rebellions against authority certainly since the French Revolution and in some cases even earlier," says Jack A. Goldstone, a sociologist at George Mason University School of Public Policy. In December the French government released a report on

Educated and jobless:

A global gallery



Heba Al Talatini, 25

Amman, Jordan

Business Administration

UNEMPLOYED

PREVIOUS SPREAD: JORGE DIRKX/REPORTERS/REDUX; OPPOSITE PAGE, FROM TOP: ANDREW TESTA/THE NEW YORK TIMES/REDUX; KIM BADAWI/REPORTAGE BY GETTY IMAGES



Students clash with London police during a December 2010 demonstration against plans to raise university tuition

the nation's Sensitive Urban Zones, also known as *banlieues,* which said that the young men in the neighborhoods find it "extremely difficult" to integrate into the economic mainstream. The heavily Muslim *banlieues* exploded into rioting in 2005; last year a series of violent attacks there brought police face to face with youths brandishing AK-47s.

A demographic bulge is contributing to the tensions in North Africa and the Middle East, where people aged 15-29 make up the largest share of the population ever, according to multiple demographic sources. The Egyptian pyramid that matters now is the one representing the population's age structure—wide at the young bottom, narrow at the old top. Fifteen- to 29-year-olds account for 34 percent of the population in Iran, 30 percent in Jordan, and 29 percent in Egypt and Morocco. (The U.S. figure is 21 percent.) That share will shrink because the baby boom of two decades ago was followed by a baby bust. For now, though, it's corrosive.

In a nation with a healthy economy, a burst of new talent on the scene spurs growth. But the sclerotic and autocratic states of the Middle East are ill-equipped to take advantage of this demographic dividend. Sitting at the fringes of a protest in Cairo's Liberation Square on Jan. 29 and wearing a bright yellow head scarf, Soad Mohammed Ali says she hasn't found work since graduating from Cairo University with a law degree—nearly 10 years ago. She says the only offer of government work she has received is cleaning jobs at $40 a month. At age 30, Ali says, "I am old now."

For the young jobless, enforced leisure can be agony. Musa Salhi, the Spanish soccer player, says, "I feel bored all the time, especially in the mornings. My parents really need and want me to start working." In Belfast, Northern Ireland, 19-year-old Declan Maguire says he applied for 15 jobs in the past three weeks and heard nothing back. "I would consider emigrating, but I don't even have the money to do that. It is so demoralizing."



Mohammad Sadati, 23

Cairo

Economics

UNEMPLOYED

For decades, Mubarak coped with Egypt's youth unemployment problem by expanding college enrollments. That strategy couldn't last forever. This past March, scholars Ragui Assaad and Samantha Constant of the Middle East Youth Initiative, a venture of Brookings Institution and the Dubai School of Government, put it bluntly: "In Egypt, educated young people who spend years searching for formal employment, mostly in the public sector, are now forgoing this prospect as the supply of government jobs dries up. Formal private sector employment—quite limited in the first place—is not growing fast enough. ... Hence, young people are left with either precarious informal wage employment or expected to simply create a job for themselves in Egypt's vast informal economy."

Mubarak gave no sign of knowing how explosive the situation was, but his ministers did state repeatedly that Egypt needed rapid growth to soak up new jobseekers. The country started getting some things right in 2004, when Mubarak appointed a business-minded government under Prime Minister Ahmed Nazif. The nation lowered corporate taxes and import tariffs, privatized telecom, and expanded exports. The economy grew 7 percent annually from 2006 through 2008, dipped below 5 percent in 2009, and was on track for over 5 percent growth this past year, according to the International Monetary Fund.

That was good and bad. While growth is essential for easing social tensions in the long term, it can exacerbate them in the short term in a country such as Egypt. That's because, former Finance Minister Youssef Boutros-Ghali told *BusinessWeek* several years ago, the first fruits of growth go to those who are already wealthy.

The lack of democracy in Egypt and elsewhere in the Middle East—Israel being the exception—makes matters



On Jan. 28 protesters in Tunis fight to cleanse the government of loyalists to former President Zine al-Abidine Ben Ali

worse. Goldstone, of George Mason, says Mubarak is running afoul of the "paradox of autocracy," a phrase coined by the late University of California at San Diego sociologist Timothy L. McDaniel. "Any authoritarian ruler who wants to modernize his country has to educate the workforce," Goldstone says. "But when you educate the workforce you also create people who are not so willing to follow authority. Thus you create this threat of rebellion and disorder." Democracies are "much better at managing large numbers of highly educated people," Goldstone notes. Spain's youth unemployment is even higher than Egypt's, but young Spaniards aren't trying to overthrow the government.

Even so, rich democracies ignore youth unemployment at their peril. In the 34 industrialized nations in the Organization for Economic Cooperation and Development, at least 16.7 million young people are not employed, in school, or in training, and about 10 million of those aren't even looking, the OECD said in December 2010. In the most-developed nations, the job market has split between high-paying jobs that many workers aren't qualified for and low-paying jobs that they can't live on, says Harry J. Holzer, a public policy professor at Georgetown University and co-author of a new book, *Where Are All the Good Jobs Going?* Many of the jobs that once paid good wages to high school graduates have been automated or outsourced.

The spike in youth unemployment should ease in the West as the after-effects of the 2008 financial crisis diminish. Eventually, growth will resume in the U.S., Europe, Japan, and other nations. The retirement of the baby boomers will increase demand for younger workers. "I believe the tables will turn. Employers will be lining up" for younger workers, says Philip J. Jennings, general secretary of UNI Global Union, an international federation of labor unions with 20 million members.

That's cold comfort to the young people who are out of work now. The short term has become distressingly long. Although the recession ended in the summer of 2009, youth unemployment remains near its cyclical peak. In the U.S., 18 percent of 16- to 24-year-olds were unemployed in December 2010, according to the Labor Dept., a year and a half after the recession technically ended. For blacks of the same age it was 27 percent. What keeps the numbers from being even higher is that many teens have simply given up. Some are sitting on couches. Others are in school, which can be a dead end itself. The percentage of American 16- to 19-year-olds who are employed has fallen to below 26 percent, a record low.

What's more, when jobs do come back, employers might choose to reach past today's unemployed, who may appear to be damaged goods, and pick from the next crop of fresh-faced grads. Starting one's career during a recession can have long-term negative consequences. Lisa B. Kahn, an economist at the Yale School of Management, estimates that for white, male college students in the U.S., a 1 percentage point increase in the unemployment rate at the time of graduation causes an initial wage loss of 6 percent to 7 percent—and even after 15 years the recession graduates earn about 2.5 percent less than they would have if they had not come out of school during a downturn. There's a psychological impact as well. "Individuals growing up during recessions tend to believe that success in life depends more on luck than on effort, support more government redistribution, but are less confident in public institutions," conclude Paola Giuliano of UCLA's Anderson School of Management and Antonio Spilimbergo of the International Monetary Fund in a 2009 study. Downturns, the study suggests, breed self-doubting liberals.

The coincidence of protests in Egypt and record youth unemployment elsewhere has caught the attention of the world's most powerful capitalists and



Robert Harington, 23

London

Biochemistry

UNEMPLOYED

TOP: JOAO PINA/THE NEW YORK TIMES/REDUX

diplomats. At this year's World Economic Forum in Davos, Switzerland, held while Cairo was in chaos, the hallways buzzed with can-do talk about improving employment opportunities for the young. Even before the latest whiff of grapeshot, the U.N. declared the year beginning last August as the International Year of Youth. In December the Blackstone Group and CNBC held a conference in London with top experts to discuss solutions to youth unemployment. Companies from AT&T to Accenture to Siemens are working on ways to prepare high school and college students for the working world.

The only surefire cure for youth unemployment, however, is strong, sustained economic growth that generates so much demand for labor that employers have no choice but to hire the young. Economists have been breaking their teeth on that goal for decades. "If we knew how to get growth right we'd win the Nobel Prize," says Wendy Cunningham, a specialist in youth development at the World Bank in Washington.

In the absence of a growth panacea, economists have been working on microscale solutions, such as training programs to smooth the transition from school to work. No magic bullets there yet, either. "We seem to lack a creativity about how to address the issue. I can't point any fingers because I certainly don't have the answers," says Sara Elder, an economist at the ILO in Geneva.

One reason answers are so scarce is that rigorous measurement of antipoverty programs became widespread only in the past decade, thanks in part to the influence of economists such as Esther Duflo and Abhijit Banerjee of the Abdul Latif Jameel Poverty Action Lab, based at Massachusetts Institute of Technology. Serious analysis requires tools such as randomized trials and control groups that most bureaucrats and do-gooders don't know. And measuring long-term impact takes a decade or more.

One finding that has emerged is that more education is not always better. What matters is matching the skills of the workforce to the skills that employers demand. In Iran, where the percentage of people aged 15 and over with postsecondary degrees has soared from 2.5 percent to 10.5 percent over the past 20 years, the education system has become "a giant diploma mill," says Djavad Salehi-Isfahani, an economist at Virginia Tech. Egypt and Tunisia are headed in that direction; in 1990, only about 2 percent of their people aged 15 and over had post-secondary degrees, but by 2010 the ratios were up to 6.7 percent for Tunisia and 6 percent for Egypt, according to Harvard University's Center for International Development.

The extra schooling didn't help. Much of the anger that boiled over in the two nations, in fact, came from college graduates who couldn't put their degrees to work. Typical is Saad Mohammed, 25, a 2010 graduate of Cairo's venerable Al-Azhar University, interviewed in Liberation Square between protests. He feels betrayed that he has been unable to find work in his chosen field, "origins of religion." Mohammed hopes that "a new government will give me a job in a religious charity." The mismatch is worst for young women in the Middle East, who are getting as much advanced education as men but have far fewer job opportunities.



Ceren Ozbasaran, 27
Istanbul
Psychology and Criminology
UNEMPLOYED

China, too, has produced more college diplomas than it can make use of. The number of graduates has quintupled in the past decade, and "the Chinese economy has just not been able to create that many jobs for high-skilled labor," says Anke Schrader, a researcher in Beijing at The Conference Board's China Center for Economics and Business. Manpower says that according to its analysis of the Chinese labor market, newly minted technical-school graduates are earning as much or more than new university graduates, with monthly pay of 2,000 to 4,000 renminbi a month, and in some cases 6,000 renminbi, vs. 2,000 to 2,500 for the university grads. (Monthly pay of 2,000 renminbi equals $3,600 a year at market exchange rates.)

In the U.S. and much of Europe, the problem is just the opposite of the Arab world's: not too much college education but too little. According to a study by the Organization for Economic Cooperation and Development, less-educated youth are 4.6 times as likely to be unemployed as more-educated youth in the U.S.–a measure of the potency of knowledge in a knowledge economy. That means that the U.S. has fallen off the top of the world league table for college graduation rates at the worst possible moment. As of 2008, only 60 percent of students in American four-year schools had managed to graduate within six years, according to the National Center for Education Statistics.

Even in technologically sophisticated nations such as the U.S., college isn't for everyone. But traditional vocational programs, though popular, are not the best solution for youth unemployment, according to effectiveness research conducted by the World Bank. Cunningham, who has a PhD in labor economics and has worked in youth development at the bank since 2000, says vocational programs "often are set up without a good understanding of the demands in the labor market and become obsolete very quickly. They have staff that stay on and on. They don't have the money to update their technology."

More successful are programs that are tightly linked with employers. The *Jóvenes* (Spanish for youths) programs in several Latin American nations require that an employer sign a document promising to take their graduates as interns, and they teach life skills alongside technical ones. Employers range from bakeries to clothing manufacturers to computer repair shops. The question, says Cunningham, is whether the *Jóvenes* programs can be scaled up from hundreds of participants to hundreds of thousands.

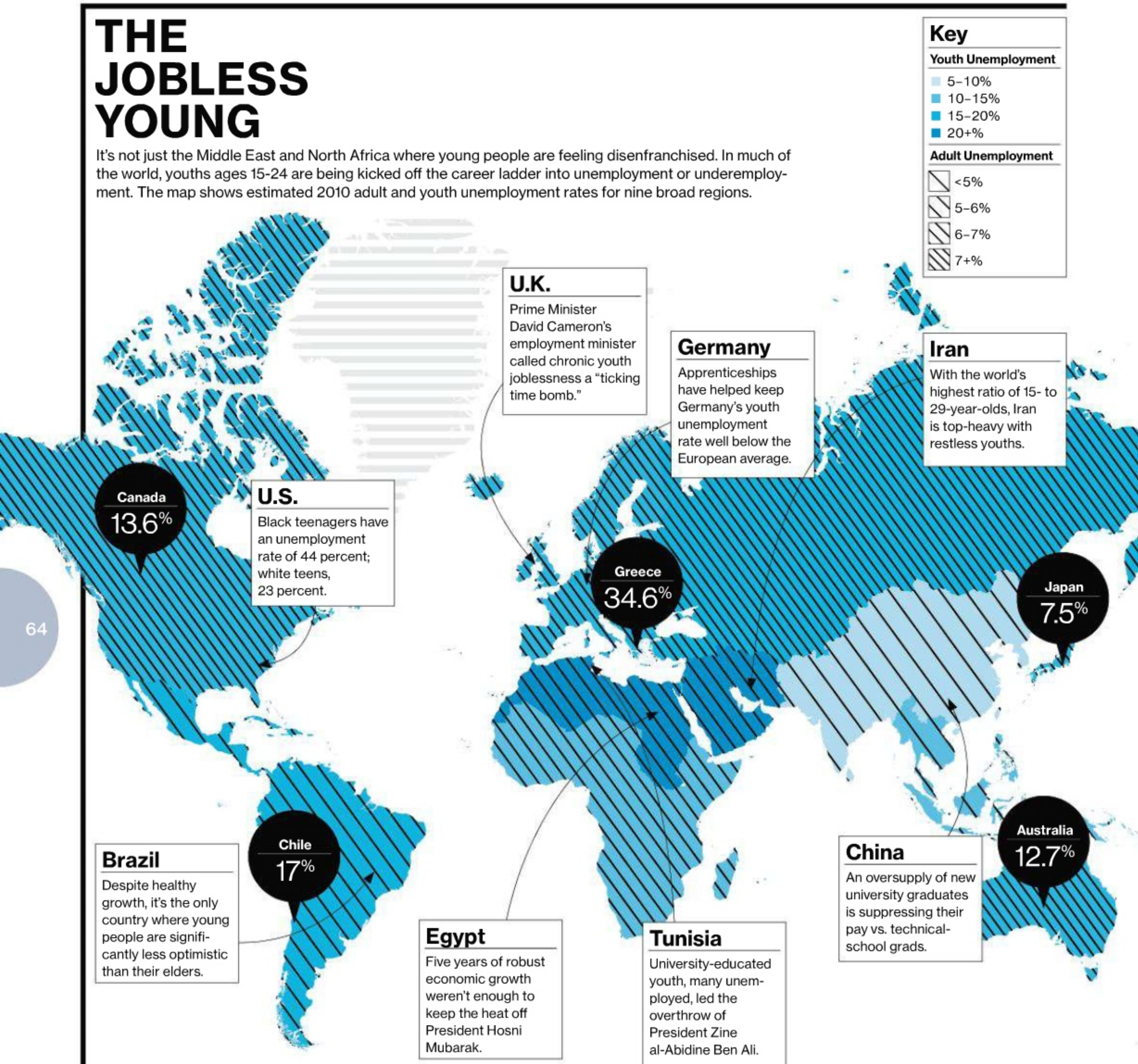


Pratin Rathod, 21
Ahmedabad, India
Robotics
UNEMPLOYED

These days there's a newfound appreciation for an ancient work arrangement, the apprenticeship, because it greases the transition from learning to doing. Germany and Austria experienced milder youth unemployment in the global downturn partly because of blue-collar apprenticeship programs, says Stefano Scarpetta, deputy director of the directorate

THE JOBLESS YOUNG

It's not just the Middle East and North Africa where young people are feeling disenfranchised. In much of the world, youths ages 15-24 are being kicked off the career ladder into unemployment or underemployment. The map shows estimated 2010 adult and youth unemployment rates for nine broad regions.



Labor Curves

In the youngest age group, the blue line (share of the unemployed) is higher than the black line (share of the labor force). That means young people bear a disproportionate share of unemployment.

- Share of the unemployed
- Share of labor force



DATA: ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, INTERNATIONAL LABOR ORGANIZATION, NATIONAL STATISTICAL OFFICES. UNEMPLOYMENT RATES ARE FOR NOVEMBER, DECEMBER, OR LATEST QUARTER, EXCEPT FOR GREECE AND CHILE, WHICH ARE OCTOBER

of employment, labor, and social affairs at the OECD in Paris. Last year, the International Labor Organization says, Germany's youth unemployment rate was 13.9 percent, compared with a Europe-wide average of 21.2 percent and 21 percent in the U.S.

In an update on the apprentice idea, countries such as the Netherlands encourage university students to gain work experience while enrolled. Scarpetta says 70 percent of Dutch youth ages 20-24 are getting some work experience. By contrast in Italy and Portugal only about 10 percent work while in school. The Netherlands' youth unemployment rate is just 11.2 percent.

Something similar is catching on in the U.S. AT&T, with almost 270,000 employees and an annual training budget of nearly $250 million, is trying to smooth high school students' transition to work with a program called Job Shadow that exposes students to the realities of employment. Insight into the minds of American teenagers has made AT&T executives realize the magnitude of the challenge. "I had three students shadowing me a while ago—juniors in high school," says Charlene F. Lake, AT&T's chief sustainability officer. "When I asked them what they wanted to do after high school, two of them hadn't thought about it. One girl said she'd like to teach and expressed surprise that she needed more education to do that. She didn't even realize she had to go to college."

For many young people who lack work experience, structure is the key. "You need to have rules and regulations," says Executive Director Mary B. Mulvihill of the Grace Institute in New York, which offers tuition-free training in personal and office skills to help "underserved" women become self-sufficient. "You need to say, 'If you do this, look how your life is going to change.' If it's more loosey-goosey, I don't think it works."

If the purpose is to create jobs, as opposed to just filling them, loosey-goosey may be exactly what's needed. Entrepreneurship—with all its guesswork and improvisation—could be the most underexploited means of reducing youth unemployment. In 2008 the University of Miami started an entrepreneurship program called Launch Pad inside its career center to send the message that starting your own company is a valid career option, not just a class to take.

Since then, University of Miami students and recent grads have launched 45 companies. Coral Morphologic collects and raises corals for sale to aquarium owners. Sinha Astronautics has conceived of a space plane for launching satellites into low-earth orbit. Audimated, a music website, allows fans to make money by promoting their favorite indie artists. The man who launched Launch Pad is William S. Green, senior vice-provost and dean of undergraduate education. "Young people are interested in managing their own lives and are a little bit cautious about big corporations," he says. "This has become the largest single student activity on campus."

After Miami's entrepreneurship initiative caught the eye of Stephen A. Schwarzman, the billionaire head of private equity firm Blackstone Group, the Blackstone Charitable Foundation last year launched a similar program in southeastern Michigan with Wayne State University and Walsh College. On Jan. 31, as President Barack Obama announced his Start-up America initiative at the White House, Blackstone said it would expand what it also calls LaunchPad to five more cities, as yet unnamed, devoting $50 million over five years. Schwarzman, buttonholed at the World Economic Forum in Davos, said Blackstone "started getting focused on this area when it became clear that [government efforts] were not in our judgment going to lead to significant declines in unemployment."



Spyros Pistikos, 26
Athens
Communications and Media
UNEMPLOYED

To free-market economists, one solution to youth unemployment is simple: Clear away the government-imposed obstacles to hiring young people. They blame high minimum wages, for instance, for discouraging companies from hiring promising young people who haven't had a chance to accumulate the knowledge or experience to justify being paid even the minimum wage. Following that counsel, most European countries, where minimum wages are high relative to average pay, have lower minimums for young workers. (The evidence is that high minimum wages do exclude some young people, while benefiting others by raising their pay.) Likewise, too-strong protections for the permanent workforce can hurt young people because they aren't similarly protected and bear the brunt of downsizing in hard times, the ILO warned in a 2009 report.

Right or wrong, the free-market argument hasn't carried the day: Britain and New Zealand actually raised their minimum wages during the global downturn. And the argument for the negative effect of worker protections hasn't convinced Austria and Germany, which have strong employment regulation and yet have had healthier job markets in the past two years than countries such as the U.S. with fewer worker protections. Thea Lee, deputy chief of staff at the AFL-CIO, argues that unions can't be blamed for high youth unemployment: "Business likes to have workers with no power, no rights, no protections."

That's a bit harsh. After all, company executives are squeezed too, and hiring neophytes is costly. Joerres, the Manpower chief, blames the faster pace. "Businesses did more training when the life cycle of their products and employees was longer," he says. "Now if the life cycle of your product is 18 months and it takes 12 months to bring your employee up to speed, you lose."



Camille de Rostolan, 25
Paris
Engineering
UNEMPLOYED

Chronic youth unemployment may not be fixable. But there's evidence it can be reduced through the concerted efforts of government, labor, business, education, and young people themselves. Luckily the soil is fertile: All over the world, the *hittistes* and *shabab atileen*, NEETs and *freeters* and boomerang kids are hungry for a chance to thrive. Says John Studzinski, senior managing director at Blackstone Group: "To a certain extent, all you can do with youth employment is plant seeds." B

—With Stanley Reed, Carol Matlack, Dexter Roberts, Diane Brady, Caroline Winter, and bureau reports



The Happiest Man in Detroit

Ford CEO Alan Mulally took a broken car company and made it the world's most profitable. Here's why this fairy-tale turnaround is still far from complete

By Keith Naughton

Photographs by Jeff Riedel



Quarter after quarter for almost two years, the news out of Ford Motor was astonishingly good.

Under Chief Executive Officer Alan Mulally, who'd joined the company from Boeing in 2006, Ford had not simply avoided bankruptcy and a federal bailout, it had turned itself into the world's most profitable automaker. It beat analyst estimates for seven consecutive quarters and drove its stock to a nine-year high of $18.79 on Jan. 27, up from $1.26 on Nov. 19, 2008. Last year, hits such as the Fusion family car and Fiesta subcompact propelled sales of Ford models upward at twice the rate of the overall market. And the 65-year-old Mulally, a gifted and relentlessly upbeat salesman, wasted no opportunity to look into the eyes of analysts and reporters, squeeze their forearms, and remind them how "fabulous" Ford had become.

Late last year, however, Mulally began to see some new signs of trouble. Inside the Thunderbird Room on the 11th floor of Ford's Dearborn (Mich.) headquarters, the windowless conference chamber where Mulally meets around a circular table with his 15 top executives every Thursday at 7 a.m., some of the news suddenly wasn't good. At these 2½-hour meetings, known as BPR for business plan review, he requires his direct reports to post more than 300 charts, each of them color-coded red, yellow, or green to indicate problems, caution, or progress.

At the BPR, Ford Chief Financial Officer Lewis Booth might give an update on debt reduction, or Americas chief Mark Fields might go over the mix of red, yellow, and green on new model launches. (Fields is famous for being the first Ford executive to put up a red light four years ago when he delayed the launch of an SUV because of a balky tailgate, earning him applause from Mulally for his candor.) Afterward, the adjoining Taurus and Continental rooms are papered with these charts so Mulally can study them. As the CEO likes to say, "You can't manage a secret. When you do this every week, you can't hide."

The Ford executive who couldn't hide in December and January was European chief Stephen Odell. His slides told Mulally that heavy discounting was going on in the European Union, a market where there were too many car factories and too few buyers. Mulally had assured analysts that Ford would make money in Europe, but the risk of a fourth-quarter loss was rising. As the rectangles on Odell's slides turned from green to yellow to red, Mulally decided not to follow his competitors into the bargain basement. He was trying to elevate Ford's reputation; unloading cars at just above cost might have helped his quarterly return, but he was certain it would hurt his brand. "So we gave up a little bit of market share," Mulally says. "Even though that meant taking a hit to our guidance, it was the right thing to do for the long term."

What Mulally did not do was offer revised guidance to Wall Street. As a result, on Jan. 28 Ford shocked investors by posting a $51 million pretax loss in Europe—one that helped drive a companywide 79 percent fourth-quarter profit decline to $190 million, or 5¢ a share. On an adjusted basis, Ford came in 18¢ below analysts' forecasts. And despite earning $6.6 billion for the year—the most since 1999 and a stunning reversal from the $30 billion Ford lost from 2006 through 2008—investors suddenly seemed to believe Mulally had lost his touch. Ford stock traded down 13 percent to $16.27, the biggest one-day decline in 20 months.

Moving into damage control, Mulally told a conference call of analysts and reporters that he would review how Ford communicates with Wall Street to better manage expectations. Three days later he insisted that he'd done all the communicating he needed to do.

"I'm very proud of the way we provide the most accurate guidance that we can," Mulally said in a Jan. 31 telephone interview with *Bloomberg Businessweek*. "We really believe we gave very good guidance. We have a track record of exceeding everybody's expectations, so I'm sure they were building a little bit of that in."

Just don't accuse Mulally of being a cheerleader-in-chief who only communicates happy news. "I'm not Pollyannaish," he says. "I'm not enthusiastic unless there's a reason to be."

If Mulally appears to be a corporate choirboy—he sticks to blue blazers and primary-color ties, and his comments generally do stay on the sunny side—that's just a public persona. Behind the scenes, the former aerospace engineer has been shrewd, nimble, and tough, with a decision-making style based on huge data dumps and a cool assessment of global trends. When he took over Ford, he made a radically simple diagnosis—if the company was to have a future, it had to fix its namesake brand—then followed through on the implications of the idea. He sold off the European luxury lines—Jaguar, Land Rover, Aston Martin, Volvo—and improved everything about the everyday Fords. His mission is to surpass Toyota and Volkswagen not just in profit but also in reputation, even if it means suffering some bad quarters along the way.

Back in January 2008, Mulally convened his top 300 executives in a Dearborn conference center and flashed two pie charts that divided the car-buying world geographically and by vehicle size. Ford was hardly playing in two of the charts' most crucial areas—Asia and the small-car market. "As soon as he got the pie charts out, it was pretty clear to everyone," says Jim Farley, Ford's global marketing chief, whom Mulally lured from Lexus in 2007. "Alan had a vision about what was next for the company. He just wanted to make sure it was everyone else's idea, too."

Mulally's vision quest was interrupt-



Mulally at the Detroit auto show in January

ed by the fall of Lehman Brothers. As the Great Recession gripped the U.S., consumers stopped buying cars, especially the gas-guzzling SUVs that had fueled Ford's profits. While General Motors and Chrysler were spiraling toward bankruptcy, Ford, too, was burning through cash, nearly $2 billion a month. It tapped every penny of a $23 billion loan Mulally helped secure in 2006 by putting up Ford's assets as collateral. That cushion allowed the carmaker to skirt bankruptcy and a bailout, which generated enormous goodwill and drew people into its dealerships as the recovery took hold. What they found on the showroom floor were cars that looked better, drove better, and went further on a gallon of gas than the Fords of their memory.

That little revolution took place because Mulally and his team had hammered the importance of quality and fuel efficiency throughout the ranks of the company. Today Ford places above Toyota in J.D. Power quality surveys, with its cars fetching higher prices and better resale values than some Toyota models. Ford's U.S. market share rose for the second consecutive year in 2010—a feat it hadn't accomplished since 1992-93. "He's got a chance to lead Ford to the destiny it's always had but never reached," says Jeffrey Sonnenfeld, associate dean of the Yale School of Management. "There's this sense of Prometheus unleashed. "

Prometheus had some bad days along the way—bound to a rock, feasted upon by an eagle—and it hasn't always been a joyride for Mulally either. He had to eliminate almost half of Ford's workforce, then slash pay and benefits for the survivors. Yet no one calls him Chainsaw Alan or Neutron Mulally. Instead, he's Detroit's only superstar, the man who saved an American icon. "We took Draconian actions," says Executive Chairman Bill Ford, the scion who hired Mulally to replace himself as CEO. "In almost every other case, whomever was in that seat would have been villainized. And yet the opposite happened during those difficult times. Our reputation rose. I attribute that to Alan and his style."

Throughout the crisis, Mulally never let his executives forget about Ford's weaknesses in small cars and Asia. He funneled billions into new compacts and forced the company to develop models for the entire world rather than for regions. The cost savings from this run into the billions. "The first day I met Alan, I told him we had to find a way to globalize product development and that the institutional resistance had been massive," says Bill Ford. "It's something I'd started but can't say we'd made a lot of progress, and I was very frustrated by it."

To underline the importance of Asia, Mulally installed as chief there a rising star named Joe Hinrichs, who had squeezed concessions from the United Auto Workers, saving the company a half billion a year. "Alan always kept this in front of us," Americas chief Fields says, pointing to the pie charts. "As if to say, this is not only about surviving now, but it's about setting ourselves up to thrive later."

"I am standing on Henry Ford's shoulders," Mulally declares, pounding the conference table in his 12th-floor office. He jumps from his chair and gestures at the huge Ford ad that hangs there, an 8-by-10-foot blowup from the Jan. 24, 1925, issue of *The Saturday Evening Post* with the slogan "Opening the highways to all mankind." "I walk in here every morning [at 5:15 a.m.], and the light comes on, and I stop and read it—to serve all mankind. It makes me cry."

Mulally knows most of the ad by heart, and he recites it regularly. He opened his Detroit auto show press conference last month with the ad on a giant screen above the stage. In his corner office, he pivots from the framed ad to the windows overlooking Henry Ford's massive Rouge factory, still spitting out cars nearly 90 years on. "Look at the Rouge," he says, swiveling back to the ad, where the same factory floats above a hilltop as a happy family gazes up at fluffy clouds. You almost expect a Boeing Dreamliner to fly past the window. "That's your story," he says. "That's your story. For me to get a chance to serve two American and global icons both committed to safe and ef-

"I'm not Pollyannaish," Mulally says. "I'm not enthusiastic unless there's a reason to be"

ficient transportation for everyone. And you wonder why I'm smiling?"

Mulally faces challenges that might have given Henry pause. Ford still has a junk-bond credit rating and $19.1 billion in automotive debt, and it remains barely competitive in China, with just 2.7 percent of the world's largest and fastest-growing auto market. Despite gains in the U.S., South America, and Europe, Ford's weakness in Asia caused its global market share in 2010 to fall to an estimated 6.9 percent, from 7.4 percent in 2008, according to researcher IHS Automotive, which now ranks Ford fifth worldwide, behind Toyota, VW, GM, and Hyundai. The key to reversing that decline is China.

"President Nixon and Henry Kissinger flew in to see Mao to normalize relations between the United States and China on a Boeing 707," Mulally says. He wasn't far behind, as the first Westerner to sell planes to the Chinese. "Alan has a lot of experience in growing the business in Asia Pacific for Boeing," Hinrichs says. "He really envisions Ford being able to do the same."

Ford, though, is playing catch-up, says auto analyst Michael Dunne, president of Asia market consultant Dunne & Co. in Hong Kong. GM and VW established beachheads in China in the 1990s that have made them the biggest-selling foreign automakers there today. Mulally wants to make up for lost time and expects Hinrichs to generate 70 percent of Ford's growth this decade in Asia. "It's O.K. to be late to the party, provided you're well-dressed," Dunne says. "Good new products are the key to lifting market share in China. Ford in the past did not offer enough of them."

Ford is on a building binge in Asia, spending $1.5 billion on new factories, including two assembly plants and an engine plant in China. One of those, in the southern city of Chongqing, is expected to produce an SUV and a luxury car, Dunne says. Ford might even try selling a Lincoln in China, he says, where luxury cars and SUVs are the fastest-growing categories.

Mulally has to hope that selling Lincolns to the Chinese will prove easier than selling them to Americans. With an aging buyer base and an image dominated by the airport-shuttle Town Car, Lincoln has fallen to eighth place among luxury brands in the U.S., from first in 1999, when the Navigator SUV was riding high. Mulally plans to spend billions to get Lincoln back in the game. He sold the European luxury lines to funnel resources into seven new models for the brand.

The 900 Lincoln dealers who gathered to meet with Mulally in Dearborn last Oct. 4 weren't sure gratitude was in order. They were still feeling the blow from four months before, when Mulally killed Mercury, which accounted for most of their business, leaving them with nothing but a faded luxury brand—named after America's 16th President—whose sales have fallen 63 percent since 1990.

As the dealers waited to hear from the CEO inside a concert hall across Michigan Avenue from Ford headquarters, they knew their financial futures were on the line. Mercury was gone, and now Ford was asking them to spend as much as $2 million apiece to make their dealerships more luxurious and Lexus-like. In exchange, all Ford could promise was that the next-generation Lincolns—arriving from 2012 through 2014—would sell better than the current uninspired lineup, which basically consisted of Fords with bigger grilles and fancier trim.

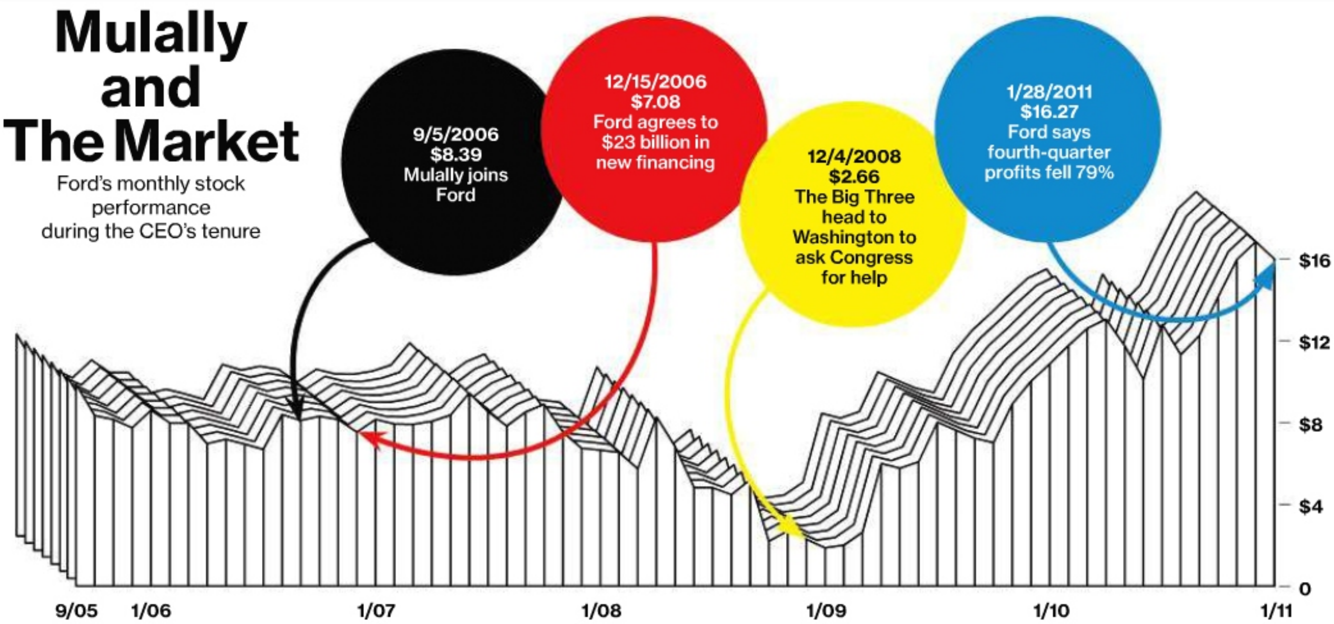
"We have some decisions to make," said Beau Boeckmann, vice-president of Galpin Motors in Van Nuys, Calif., the largest Ford dealer in the U.S. His family owns two Lincoln dealerships and was thinking about closing one because the upgrade costs would be steep. "And there's no lack of urgency, considering we don't have Mercury anymore. It will be a tough emotional decision."

Then Mulally walked in and delivered a fresh blow. If Lincoln was to transform itself from codger to contender, he said, one-third of the dealers had to go. No one could accuse him of sugarcoating it. Lincoln's slide into irrelevance, he said, had been driven in part by too many dealers chasing too few sales with too-deep discounts. Oh, and the Lexus LS 430 he owned before coming to Ford was "one of the finest vehicles in the world." Lincoln, on the other hand, "isn't where we need it to be on any level or by any measure," Boeckmann recalls Mulally saying.

When Mulally finished delivering these sentiments, the dealers stood and

Mulally and The Market

Ford's monthly stock performance during the CEO's tenure





"I've seen Alan have tough times, but probably nobody else has," says Bill Ford. "These jobs are very lonely jobs"

clapped. "He still has to fix Lincoln, and that's no small task," said Boeckmann, who was among those on their feet at the end. "But he saved our businesses. If it wasn't for Alan Mulally, Ford would have gone through bankruptcy, no question."

Reminded of the moment a few weeks later in his office, Mulally's eyes moisten. "I was surprised, and I appreciated it," he says, without offering the slightest hint that his stance might soften. "You have to deal with the current reality, not what you want it to be."

The first glimpse of Lincoln's new look was scheduled to arrive in April 2011 at the New York Auto Show, say three people familiar with Ford's plans. Mulally had intended to unveil a concept of the next-generation MKZ sedan. Larger than the current model, it also looks more elegant while retaining the prominent split-bow grille Lincoln introduced three years ago, according to two people who have seen the car.

Just last month, Mulally opted to hold back that concept car to give Lincoln's new chief designer, Max Wolff, a chance to put his stamp on the brand. Ford poached Wolff, 38, from Cadillac in December. Just when the new Wolff-designed Lincoln will make its debut remains unclear; dealers remain anxious. "They need to refine their styling," says IHS Automotive analyst Rebecca Lindland, "because some of their products are turning heads for the wrong reasons."

In 2012, Lincoln will debut its small car, known tentatively as the MKC, which is based on the foundation of the Ford Focus. A small Lincoln SUV, based on the Ford Escape, will also hit showrooms in 2012 along with a larger sport-ute aimed at taking on the Lexus RX 350, the people say. The next generation of Lincolns designed entirely by Wolff, however, lies beyond those remakes.

Lifting Lincoln is a greater challenge than conquering China, says Allan Gilmour, a former Ford chief financial officer who is president of Wayne State University in Detroit. "The luxury market isn't just sitting there with a whole bunch of vacancies waiting for Ford to arrive," he says. "It takes an ethic to do a real luxury vehicle that Ford has not previously shown." Lincoln's U.S. sales rose 4 percent last year, while Cadillac, which GM spent $3 billion overhauling a decade ago, gained 35 percent. Lincoln's sales fell 21 percent last month, while Cadillac soared 49 percent. Lexus, America's favorite luxury line, outsells Lincoln nearly three to one.

When Mulally turned 65 in August, he could have retired a hero. But he isn't going anywhere, and he wants everyone—inside and outside Ford—to know it. "We've made it through the worst recession ever, and now we've got the products people want and we're growing. I can't think of anything that's more fun than doing this right now."

It's not clear when he'll bring this performance to a close. He'll get no push from Bill Ford. "I would love Alan to stay as long as he's healthy and feels good about it and feels he's ready to take on all these tasks," says Ford.

On those rare occasions when Mulally gets discouraged, he walks 15 steps across the hall to the great-grandson of Henry Ford for counsel. "I've seen Alan have tough times, but probably nobody else has," says Ford, 53. "These jobs are very lonely jobs, and he and I have each other to let our hair down. It allows us to either blow off steam or to admit to some insecurities."

Ford says he's not worried that Mulally's deferred departure will stymie succession or chase off his ambitious lieutenants. Two of Mulally's potential successors, Farley and Hinrichs, are still in their 40s, and Fields just turned 50 last month. A fourth contender, European chief Odell, is 55 and new in his job. Ford poached Mulally from a 37-year career at Boeing after he'd been passed over for the CEO job. "Nobody's been passed over here yet," Ford says. "That next phase is yet to be written."

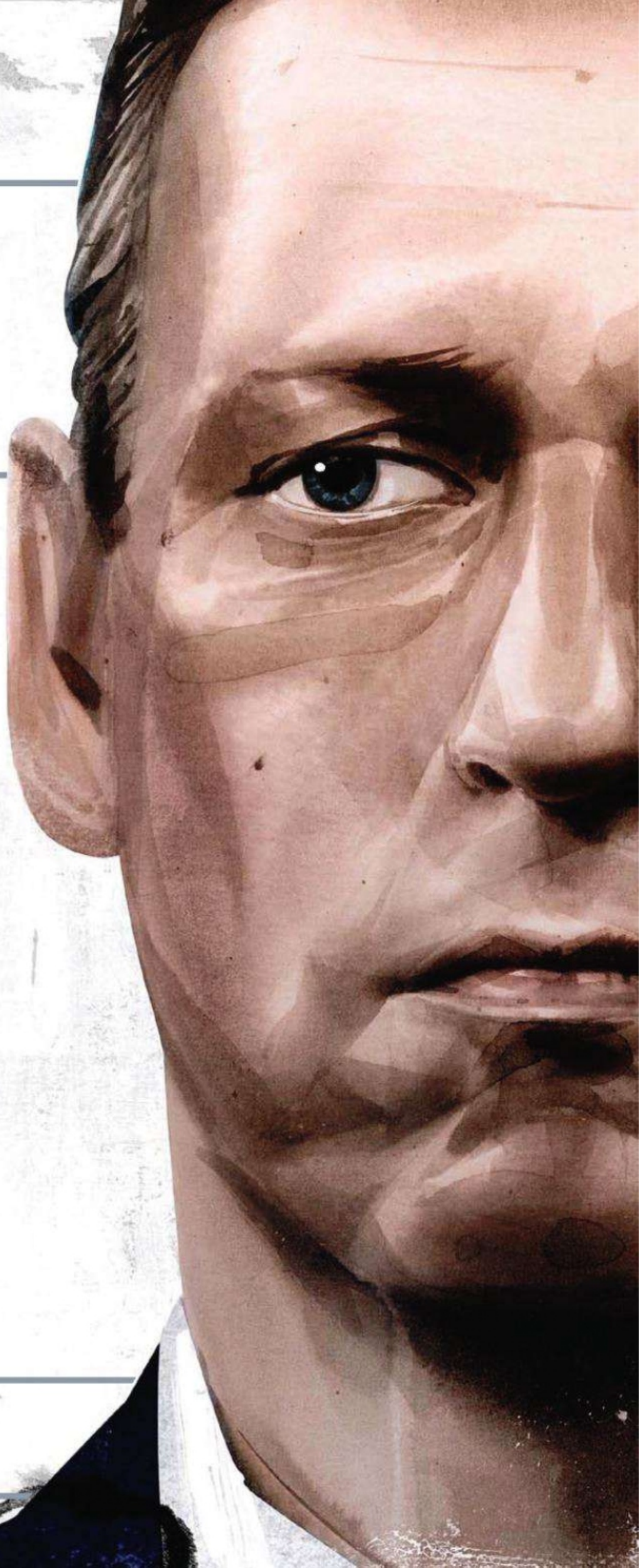
There is an odd man out: Booth, the well-traveled CFO who turned around Mazda and Ford's European operations. At 62, Booth is running out of time, but he says he's at peace with that. "Everything I have is because of Ford Motor Company, and we got preciously close two years ago to losing it all," says the son of a Liverpool, England, car dealer. "If between us all we can get this place straight, then we can retire in peace."

Mulally acts like a man who doesn't want to miss a moment of Ford's comeback. Asked by an engineer at a town hall meeting in November what gets him up each day, Mulally again recounts his morning ritual of reading that 85-year-old ad. "We're accelerating Henry's original vision," he says. "If you can't get excited about that, then you better check to see if you're alive."

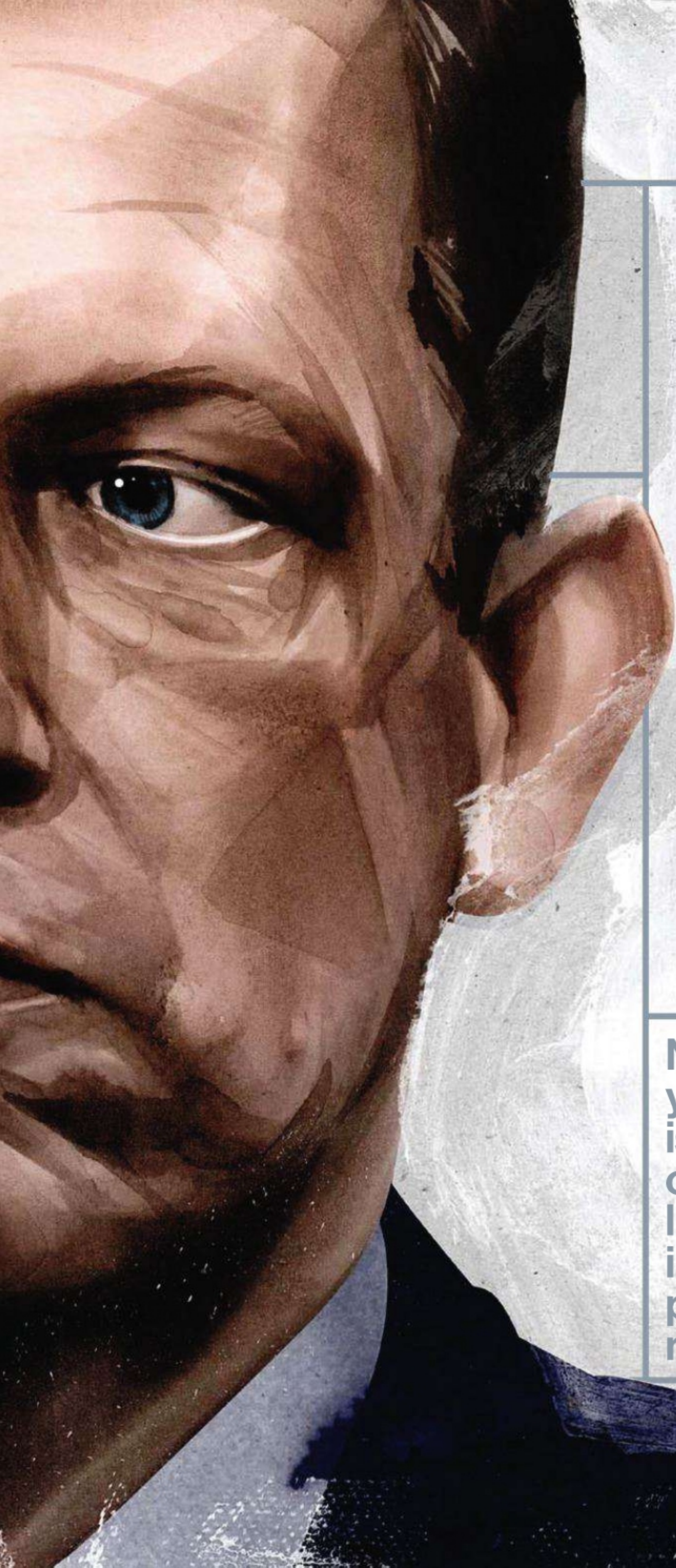
Mulally's greatest challenge may be avoiding complacency among the ranks. The automaker, which now employs 164,000 people, has a history, as Bill Ford concedes, of "losing the plot in the good times." At the November town hall meeting—with 200 employees on the day he announced record third-quarter earnings—Mulally brings up this history of squandered advantage. "We're excellent at crisis management," he says, pacing the stage. "And then it seems like we'd forget why we're here." He implores his charges to keep up the intensity, but the town hall quickly turns into a pep rally. "This is the first town hall where you've not worn a red tie," employee Adam Kessler tells the boss to peals of laughter from the raucous crowd. "It's symbolic that you don't have to project an image of success because we are success now."

Mulally, whose tie is yellow, reminds his acolytes that the job is not nearly done. "We've moved from a stage where we were trying to survive," he says. Now it's time to do "something Ford has never done before"—grow profitably. "It might feel a little stressful. It's going to take different muscles." And inflict some growing pains as well. No problem—he relishes the challenge. It's just part of a comeback that still has a very long way to go. B

Free Radical



By Romesh Ratnesar
Illustration by Hellovon



Never mind enormous yachts: Peter Thiel is spending his billions on space travel, life extension, artificial intelligence, and paying top students not to go to college

Can machines do our thinking for us?



On a chilly December night, a few hundred people gathered at San Francisco's Palace of Fine Arts for an event called Breakthrough Philanthropy. For an hour the guests engaged in the familiar social rituals of Silicon Valley, trading business cards and startup ideas over sushi, spring rolls, and pinot noir, before filing into an auditorium to listen to fundraising pitches from eight nonprofit organizations. The groups had disparate agendas, but all shared a fantastic vision for changing the world—defy death through regenerative medicine! Harness intelligence from machines smarter than the human brain! Build self-governing communities on the high seas! They also had a common benefactor: Peter A. Thiel, the iconoclastic, libertarian 43-year-old venture capitalist and macro-hedge-fund investor. When the speakers finished, James R. O'Neill, who runs the Thiel Foundation, introduced his boss as someone "who works every day to reshape the world and focus on solutions to problems other people overlook."

Thiel emerged from backstage, wearing a navy blue striped shirt, jeans, and a blazer. "The future is not an abstraction," he said. "It's something we are all participants in, helping to create and forge and shape." Thiel is not a natural performer. He has a flat, mechanical delivery that instantly deflates his attempts to inspire. After three and a half minutes, he wrapped up his remarks and encouraged the audience to stay, schmooze, and "start building the future for the 21st century."

Thiel followed the crowd into the main hall, where a Stanford University freshman named Max Marmer was waiting. Marmer had come to the event in part because of Thiel's latest philanthropic brainchild: a program that will award fellowships of $100,000 to 20 entrepreneurs under the age of 20, on the condition that they drop out of college for two years to pursue their ventures full-time. Marmer, who's launching a business consulting startup with two friends, decided to apply for the fellowship as soon as he heard about it on Facebook. At the Palace of Fine Arts, Marmer introduced himself to his idol. For the next five minutes "it was mostly me talking," Marmer says. Thiel steered him toward a partner in the Founders Fund, Thiel's venture capital firm, who agreed to listen to Marmer's pitch. Marmer has informed his parents that, whether he wins a Thiel Fellowship or not, he is dropping out of Stanford.

Three of America's defining tech geniuses are renowned college dropouts—Bill Gates and Mark Zuckerberg left Harvard University; Steve Jobs hung around Reed College but was enrolled for only one semester—and it has almost become expected that visionary technologists will stop everything to pursue a ripening idea. It's worth remembering, however, that Gates, Zuckerberg, and Jobs are anomalies. Thiel thinks it's the anomalies who matter and thinks he can create more of them. Whether you view his plan as cause for celebration or horror depends on your take on America's future. Are we hobbled by a deficit of risk or too much of it? Does government spending stimulate innovation or obstruct it? Are America's best universities assets or liabilities?

Despite his fund's disastrous recent performance—Clarium Capital Management fell about 23 percent in 2010, the third straight year of declines, according to investors—Thiel is financially set for life. He co-founded PayPal with Elon Musk and Max Levchin, was the first outside investor in Facebook, and owns a stake in a bevy of promising tech companies, from LinkedIn to Halcyon Molecular to Palantir Technologies. He made the Forbes 400 before he reached 40. After being portrayed in *The Social Network*, Thiel is perhaps the most famous venture capitalist in the world.

Despite all that, he remains troubled. Absent rapid, groundbreaking scientific breakthroughs, Thiel foresees an age when, he says, "people will have a lower quality of life, where people won't be able to retire, where governments are pushed toward more and more austerity. That will lead to a more constrained, pessimistic future. That's a big part of what is happening, and that trend is likely to continue."

Thiel has thus far put his money into the kind of bleeding-edge technologies he says can expand human possibility and stave off the future he fears: nanotechnology, artificial intelligence, robotics, space exploration. A science fiction junkie, he adheres to a worldview shaped as much by French social theorists as by *Star Trek*. "I wouldn't necessarily categorize him as a pessimist, though he can be," says David O. Sacks, a college friend who worked with Thiel at PayPal and has since founded Yammer, a social networking service. "He is very bullish about technology, but he just doesn't think it's happening fast enough."

Thiel may be the world's best-known venture capitalist



Even as Thiel pushes for a bolder future, Clarium has conspicuously bet against present macroeconomic trends—and lost. While Thiel's views, including predictions that the U.S. would face the threat of deflation and that the dollar and oil would rise, mostly have come true, the losses reflect poor market timing and risk management, according to several current and former clients. "It doesn't matter if a manager is correct in his long-term views if they don't get the timing right or manage volatility along the way," says Donald A. Steinbrugge, managing partner of Agecroft Partners, a Richmond (Va.) consulting firm that advises investors and hedge funds. Since 2008 the fund's assets have fallen 90 percent. Thiel has closed the fund's New York office and acknowledges the need for stricter risk controls. "If he was Joe Hedge Fund Manager, he would have to live and die by his track record, but that's not the case with Peter," says Tammer Kamel, president of Toronto-based Iluka Consulting Group, which advises clients on investing in hedge funds. "He's got his fingerprints on two of the most successful Web services ever developed."

Still, Clarium's free fall has exposed Thiel to attacks from those who see his investment strategy and his philanthropic ventures as expressions of a reckless, preening vanity. No initiative has provoked more howls than the "20 Under 20" Thiel Fellowship, hatched by Thiel and his foundation staff on a flight from New York to San Francisco last October and announced by Thiel during an appearance at the TechCrunch conference the next day. Writing on Slate.com, Jacob Weisberg condemned the plan as an "appalling," "nasty" idea that will encourage college students to "halt their intellectual development around the onset of adulthood, maintaining a narrow-minded focus on getting rich as young as possible, and thereby avoid the siren lure of helping others or contributing to the advances in basic science that have made the great tech fortunes possible."

What if we paid entrepreneurs to skip college?

Why don't we live at sea, in our own countries?



JIN LEE/BLOOMBERG(3)

Such critiques only help to confirm Thiel's hunch that he is right, in his view. The business credo that a college education is a prerequisite for professional advancement is, he believes, precisely the reason to encourage people to try something else. "I don't think I believe in market efficiency," he says. "If I believed in an efficient market, then none of the stuff I'm doing makes any sense."

In the various accounts of Facebook's founding, Thiel is almost always cast as a remote, brooding master of the universe, the archetypal tycoon in a black wing chair, stroking a cat. In *The Accidental Billionaires*, the 2009 book that is the basis for *The Social Network*, Thiel is described as "secretive and incredibly competitive." Also "scary as hell."

The day after the Breakthrough Philanthropy event, Thiel arrives for lunch at a restaurant overlooking the San Francisco Marina in a blue Mercedes sports car. He's modestly built, with angular features, and he has an engaging, if slightly awkward, conversational manner; on several occasions Thiel starts to answer questions while his mouth is half full. Asked about Clarium's dismal 2010 performance, he replies, "We've had a rough year. We've got some things wrong. But over time, I think we've gotten more right than we've gotten wrong." He adds: "It's not the right thing to focus on a six-month horizon. The future happens over a very long period of time. My mindset is to make sense of where things are going over the next decade and to try to think about a set of problems people haven't asked questions about."

One of Thiel's frequent themes is the folly of promoting "extensive" gains over "intensive" breakthroughs. He believes that governments and investors have an "extensive" bias when it comes to science and technology, a desire to replicate or "extend" what has already been shown to work. He perceives a dangerous shortage of the kinds of ambitious, "intensive" innovations he says are ultimately necessary for long-term growth. "My thesis is that the world is too heavily geared in the extensive direction," he says. "It's what everyone would like: a sure thing, something that gets a predictable return. I don't think that model is the right one for our world anymore. But the alternative is necessarily quite risky. And so there's no safe alternative."

Born in Frankfurt, Thiel had an itinerant childhood. His father's career as a chemical engineer took the family to South Africa, Namibia, and Ohio before the Thiels settled in the Bay Area in the late 1970s. (Thiel has a younger brother, Patrick.) At San Mateo High School, Thiel finished first in his class and was a nationally ranked chess master. He majored in philosophy at Stanford, where he studied under René Girard, a French émigré professor who coined the term "mimetic desire," the idea that people want things they perceive as objects of other people's desire, giving rise

to a herd mentality. To Thiel, mimetic desire provided a way to explain everything from stock market bubbles to political correctness on campus.

In 1987, Thiel founded *The Stanford Review*, a conservative newspaper that became an outlet for student jeremiads against multiculturalism, speech codes, affirmative action, feminists, and ethnic and gay campus groups. Sacks, who worked with Thiel at the *Review* and succeeded him as its editor, says, "We thought the people on campus were way outside the mainstream, and if the people who were funding the university—the alumni, the donors, the American taxpayer—knew what was going on, they would be pretty outraged."

Thiel stayed at Stanford for law school and remained embroiled in the culture wars, co-authoring a book with Sacks in 1995, *The Diversity Myth*, which decried multiculturalism at the university. He clerked for federal judge James L. Edmonson, wrote speeches for former Education Secretary William J. Bennett, and worked at Sullivan & Cromwell and Credit Suisse First Boston in New York before moving back to California in 1996. In 1998, Thiel met Levchin and, over breakfast in Palo Alto, launched the company that became PayPal. Thiel and his co-founders defined their mission in historical terms. They saw PayPal as a vehicle for realizing the libertarian dream of a global financial marketplace in which transactions took place entirely outside the reach of governments. The company's T-shirts read THE NEW WORLD CURRENCY. "There was an idealistic element to it—that's what everyone within Peter's circle of friends talked about," says Ajay Royan, a PayPal veteran who is now the managing director of Clarium. "The business side was secondary to the vision."



What if there were only engineers in Congress?

Thiel says that "there were a lot of cool, interesting questions we wanted to engage in, but at the same time we had to develop a very detailed, specific plan" to enable people to buy and sell items seamlessly on eBay. It worked: PayPal weathered the Internet bust and went public in February 2002. Eight months later, eBay bought the company for $1.65 billion. Thiel, who had initially invested $240,000, walked away with $60 million, which he used to launch Clarium Capital, the hedge fund, and the Founders Fund, an early-stage venture capital shop. Two years later he agreed to a meeting with Zuckerberg, then a Harvard sophomore, and Sean Parker, a co-founder of Napster who was helping Zuckerberg raise funding for his fledgling social networking site, Thefacebook. Thiel lent Zuckerberg and Parker $500,000 in exchange for a 10 percent stake in the new company. Thiel sold half his shares in 2009, mostly to Digital Sky Technologies. Based on Facebook's current valuation—a number that fluctuates depending on whom you ask and, seemingly, the minute you ask—a conservative estimate of his remaining stake is about $1.5 billion.

There's no evidence that Thiel's good fortune has softened his edges. After he was subject to ridicule on the Internet for revealing in 2007 that he lived at the Four Seasons in San Francisco and drove a McLaren, he has guarded his privacy and lashed out at those who invade it. When the gossipy website Valleywag outed Thiel as gay in late 2007, he responded by branding it "the al-Qaeda of Silicon Valley" and calling its reporters terrorists. In a 2009 essay titled "The Education of a Libertarian" published on the Cato Institute's website, Thiel wrote, "I no longer believe democracy and freedom are compatible" and that the "broader education of the body politic has become a fool's errand." Most notoriously, the essay suggested that the advent of women's suffrage in the 1920s had "rendered the notion of 'capitalist democracy' into an oxymoron," as women, in Thiel's view, tend not to support laissez-faire policies.

Are democracy and freedom even compatible?



Thiel is now at pains to play down his image as a radical ideologue. "I do tend to think that a libertarian society in which there is more economic and personal freedom is a better society, but there are all sorts of caveats," he says. Take Facebook. "If you believed in radical autonomy and the idea that we're all self-contained individuals—a kind of caricature version of Ayn Rand's world—then the social networking thing would be one of the most ridiculous things imaginable. Why in the world would you care about friends or sharing or being connected with other people? I'm very skeptical of centralized power, and I believe personal and economic freedom are important—but I also believe we are living together on the same planet and that human society exists and that human beings are born into this world and live and develop."

Except for a few donations in the most recent electoral cycle (to Rand Paul and in support of marijuana legalization), Thiel has given up on politics. He says he is "not dogmatic" about whether government should play a role in stimulating the kinds of intensive technological innovations he thinks the country needs, just that he believes the political class isn't smart enough to make it happen. "Only 35 out of

JIN LEE/BLOOMBERG(2)



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“My only candidate for a bubble in the U.S. right now is education,” says Thiel

535 members of Congress have any background in science or technology,” he says. “That’s why I believe the government thing is so hard to fix–the people there don’t actually believe these are important problems. Maybe the answer would be to change the other 500 people and replace them with engineers. But then you’re not really talking about a practical option.”

In Thiel’s view, the biggest threats to innovation emanate not from Washington but from a sector Americans tend to view as one of the country’s greatest strengths: higher education. His antipathy for its elite universities dates to his time attending one. In *The Diversity Myth*, Thiel predicted that unless they reformed themselves, institutions such as Stanford would face “massive and unprecedented displacement. ... New educational venues may arise and meet demands that are no longer being satisfied by the existing institutions.” Where once he subscribed to the idea that the system could be fixed from within, Thiel is now certain some students are better off opting out of it altogether. “A necessary condition for a bubble is that [something] is believed to be extremely valuable, but which very few people are thinking about,” he says. “And my only candidate for a bubble in the U.S. right now is education.” He continues: “People can’t do anything entrepreneurial or innovative or even nonprofit–anything that’s not safe and well-paying–because they have this mountain of debt. And so education is something that has become a retardant to technological innovation and progress, even though the common perception is the exact opposite.”

The Thiel Fellowship is probably the first scholarship aimed at college-age students that stipulates that recipients not go to college. Representatives from Thiel’s five-person foundation say they have received a few hundred applications from more than 25 countries. Applicants had to submit two 1,000-word personal statements. One was in response to: “Tell us one thing about the world that you strongly believe is true, and that most people think is not true.” The other answered: “How do you want to change the world?” Once selected, the 20 winners will be given $100,000 to cover living expenses in the Bay Area while they spend two years developing the Next Big Thing. Thiel insists that the goal isn’t necessarily to find the next Zuckerberg, but rather to prod more young people to question what they’re getting out of their college experience.

“The main thing I’d say is that people should think about it,” he says. “I certainly did not. I got good grades in high school. I went to college. I got good grades in college, I went to law school. When I look back, I have no regrets. But if I could do it over, I would have reflected on it a lot more rather than it being this thing that I reflexively did.”

There is something irksome about Thiel’s critiques of a system from which he has benefited so handsomely. And it’s easier to extol the virtues of the Silicon Valley entrepreneur’s life when you are already leading the fantasy version of it. Thiel’s vision of a society full of entrepreneurs and innovators developing life-extending technologies is a seductive one and may well be the only hope for avoiding chronic economic decline. But it’s worth asking whether people will truly be better off if more bright young students follow the path Max Marmer has chosen.

A month after meeting Thiel at the Palace of Fine Arts, Marmer has quit school and moved out of his parents’ home in San Francisco. He’s living in the pool house behind a friend’s place in Atherton, near Palo Alto, where he and his partners are working on a startup devoted to developing a “management science” for boosting the success rate of other startups. “Have you seen *The Social Network*? The house looks a little like that,” Marmer says over the phone in early January. “A few people who have come by have actually said, ‘Oh, it’s just like Facebook.’”

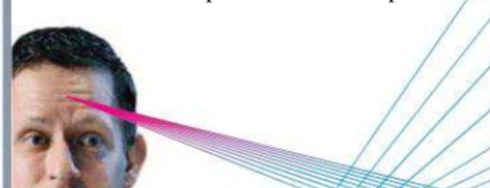
Marmer is waiting to hear whether he has won a Thiel Fellowship, though he’s concerned that his age–he turned 20 in September, before applications were due–may disqualify him. Regardless, Marmer says he has found his purpose. “People talk a lot about college as one of the best times of their lives. But it was pretty clear I had to make [a] choice between enjoying campus life or continuing to pursue my passion for entrepreneurship. I tried to do both, and when that wasn’t working, I decided to choose this.” If all else fails, Marmer says, he can always go back to Stanford someday. “They’re really flexible. I can take up to two years leave of absence, and even after that I’ve heard it’s not that hard to get back in. If I change my mind, I know I haven’t really closed any doors behind me.”

He pauses, then says: “But I don’t anticipate that. If this doesn’t work out, I’ll probably go and start another startup.” B

—*With Saijel Kishan*

Romesh Ratnesar is a Schwartz Fellow at the New America Foundation.

Can regenerative medicine make us live forever?



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Russian boutiques push back against the oligarch chic look Page 86

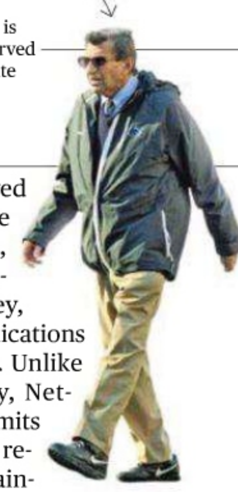


FROM TOP: NATALIA KOLESNIKOVA/AFP/GETTY IMAGES; JAMES PORTER/GETTY IMAGES

The Tragic Fall of Reserved Parking

In a blow to the corporate feudal system, companies are ridding their lots of reserved spaces. *By Joel Stein*

Etc. Reserved Parking


Joe Paterno, 84, is not allowed a reserved spot at Penn State

Just as Hollywood studios were releasing their pre-Christmas Oscar contenders, a seismic shift was taking place on the Sony Pictures lot. "This went all the way up to Michael Lynton and Amy Pascal," says Manny Rodriguez, Sony's security operations manager, referring to the formidable studio heads. On Dec. 13, Sony broke with Hollywood tradition and completed a reduction of personally reserved parking spaces on its lot from more than 1,000 to 115.

Rodriguez, who oversees parking and events, had noticed that about $800,000 per year was being spent on valet services since—with many producers leaving their reserved spots vacant—there were never enough spaces. The hardest part of that battle, he recalls, was removing the personalized nameplates, long considered as important a Hollywood status symbol as the right to throw coffee at assistants. "It was Dogfight City," remembers Rodriguez. "The parking public was so pissed off. They said we'd have to wear bulletproof vests across the lot." So far, though, he's had his way. "I had a pretty big hoo-ha from a pretty big director who wanted his name on the wall. He said, 'I'm going to make my own sign.' " As Rodriguez remembers the standoff, he becomes serious. "I told him, 'We're going to tear it off!' "

As one of the last remnants of the corporate feudal system, reserved spots have nearly disappeared from office lots across the country. If you've wondered why income disparity is growing, it's probably because there's no longer any other reason to climb the corporate ladder. In an age of increasingly egalitarian office culture, reserved parking has become déclassé. "People who need the designated office space, they're probably not the right employee for Netflix," says Steve Swasey, vice-president of corporate communications for the on-demand video company. Unlike pretty much every other company, Netflix doesn't have expense account limits (just don't go nuts!) or vacation day restrictions (take a break!), so it certainly doesn't have reserved spots. "If I said to our CEO or head of HR that we should have reserved parking spaces," Swasey says, "they would not know how to deal with that question."

"The parking public was so pissed off. They said we'd have to wear bulletproof vests across the lot"

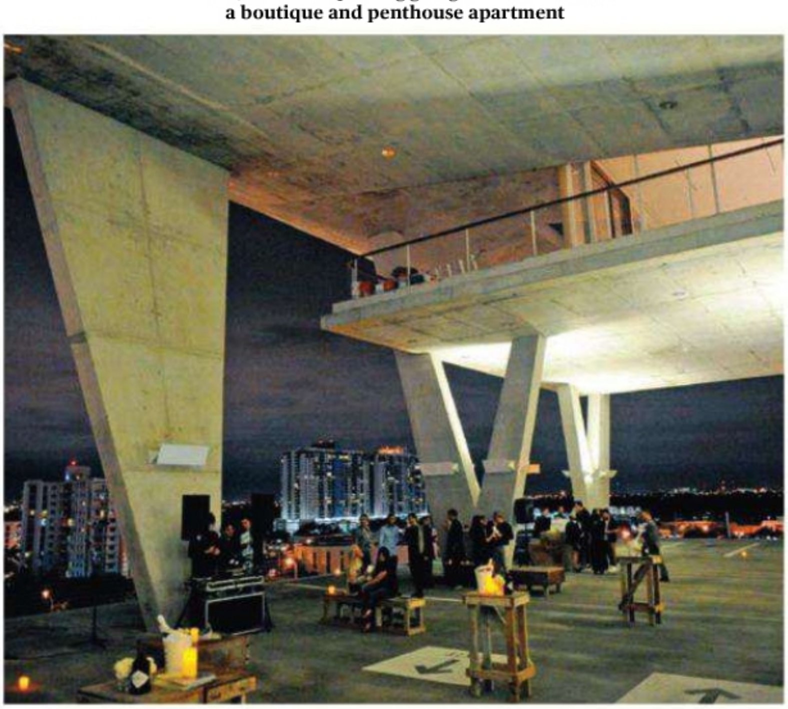
Google, which shuttles many of its employees to its Mountain View (Calif.) campus, offers reserved parking, but only for pregnant women and people needing outlets to plug in their electric cars. Other tech operations have followed their lead. "As technology companies shifted from the East to West Coast," says Simon Hartley, director of sales and marketing for Arlington (Tex.)-based Thursby Software Systems, "their success, in part, was due to dropping the old management approaches embodied in ideas like reserved parking."

Reserved spots have also vanished because they're expensive. "It's actually a very poor allocation of [funds]," says Helen Sullivan, communications counsel for the Fredericksburg (Va.)-based International Parking Institute, the industry's trade organization. (Banner initiative: "Parking Matters"; monthly magazine: *The Parking Professional*; annual expo: May 22-25 in Pittsburgh, with keynote speaker Rocky Bleier, four-time Super Bowl champion and expert parker.) Clyde B. Wilson, president and chief executive officer of the Parking Network, a consulting company that does financial audits of parking lots, says a parking management company often will oversell an office lot by 15 percent because only about 85 percent of workers show up every day. Reserved spaces that remain empty when the car owner is out drive up costs for maintenance, security, and real estate.

Big Parking has become such a serious business—valued at more than $18 billion in 2008 by research firm Marketdata Enterprises—that a developer in Miami's South Beach hired the architecture firm Herzog & de Meuron, which designed the National Stadium in Beijing, to create a $65 million public garage. Built last year, it houses a glass-walled clothing boutique and a penthouse apartment. It charges four times as much as nearby garages do for parking, and up to $15,000 for special events. People even get married there.

In uncertain times, however, parking has become a crucial line item, as it was for Sony Pictures. "Most of the private sector is now much more concerned with generating as much revenue as possible out of parking," says Barbara Chance, who runs a Philadelphia-based parking consulting company, Chance

A new $65 million parking garage in Miami houses a boutique and penthouse apartment



Management Advisors. The company has counseled Princeton University, the Carlyle Group, and the Kuwaiti government, and Chance has been profiled twice in *Parking Today*, *The Parking Professional*'s top competitor. She says the decline in reserved spaces has to do with managers' recent need for anonymity. "If you're the boss or a manager and someone is angry at you, then they can find your car," she says. "There's a lot more tension now, it's a tougher time."

People who have held onto their reserved parking spaces have also become increasingly annoying. "They call me all day. They call me even if it's their customers who are in their space. They'll have them towed," says Paul Mann, director of operations for Elite Parking in Atlanta. "The higher-ups are a pain in the ass." Reserved spots, it seems, make people power mad in a way that titles, office space, or money don't. "When someone gets a promotion, the first thing they ask is, 'Do I get a spot now?' " says Mann. "Before they want their money, they want their spot."

There are four businesses, however, where reserved spaces are holding on: hospitals, universities, government, and–with the exception of Sony–movie studios. One parking consultant, who spoke on the condition of anonymity because hospital parking politics are so ferocious, says nurses often curry favors with doctors for their spots, which must be the premise of at least one late-night Cinemax movie. Hollywood studios employ people to reassign spots each time a production starts up or tanks. Robert Evans, who ran Paramount Pictures from 1966 to 1974, still has a space there. And it's a good space. So good that he declined to discuss it for this article.

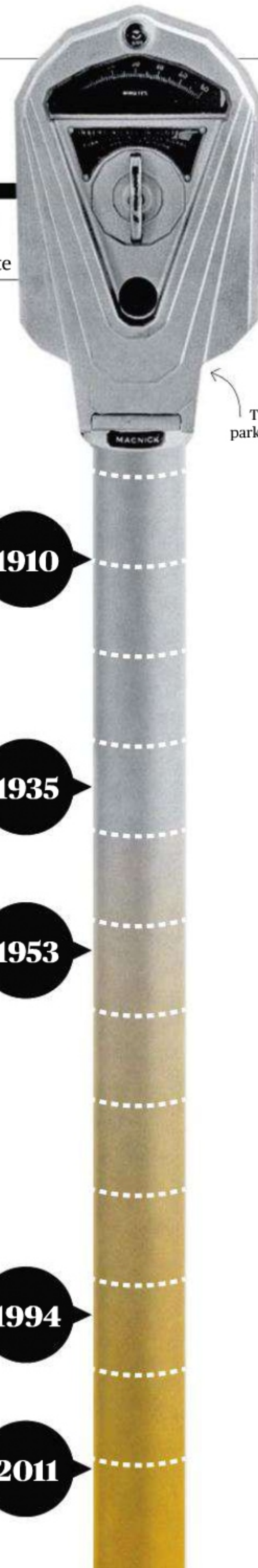
College professors are also notoriously demanding. "Parking is the strangest little animal you've ever set your eyes on," says Doug Holmes, the interim director of transportation services at Pennsylvania State University. At other schools, professors have reserved spaces at multiple sites throughout campus, depending on where they teach. "You've got a sea of signs across campus that you need to maintain. It's a royal pain," says Holmes.

Though not at Penn State. The university reserves only 60 of its 17,500 parking spaces, which was the closest that higher powers would let them get to zero. "You get enough people with enough clout and they're going to have a reserved space," says Holmes. "When the president says, 'I'm going to have a reserved space,' he's going to get it."

The university's parking policy states that only senior vice-presidents or above get a spot, for $86 a month. Penn State's legendary football coach, Joe Paterno, has won more games than any other coach in major college history. He's contributed more than $4 million to the school. He's also 84. And he has to fight for a spot like everybody else. "Joe Paterno is not a senior vice-president," says Holmes. "If he has to go an extra 10, 15 feet, he walks." Ⓑ

Great Moments In Parking History

The industry's most important innovations, according to Shawn Conrad, executive director of the International Parking Institute



The first parking meter

1910



The Multilevel Garage

The Palmer & Singer Manufacturing Co. garage is one of the earliest multistory garages known to historians. It predates even the multilevel unit at Chicago's LaSalle Hotel. These early structures were known for their wide spaces, which helped neophyte drivers.

1935

The Parking Meter

Carl C. Magee, the *Oklahoma City News* publisher who later ran unsuccessfully for the Senate, patented the first parking meter to keep employees from taking spots in front of retail stores for eight hours. "The concept at first was hard to grasp," explains Conrad. "They envisioned everything being for free."

1953



Wheel Clamp

The invention of Frank Marugg, a violinist in the Denver Symphony Orchestra. The "Denver Boot" was meant to do for cars what the Oregon Boot did to prisoners. A copy of the original is in the Smithsonian. The Boot spoke to a central tenet of modern parking. Says Conrad: "We're trying to modify behavior."

1994



Cashless Meters

Some new meters in Washington, D.C., and Atlanta allow street parkers to call a number and pay the meter by mobile phone. When their time is running out, they can buy additional minutes via text message. "This is going to grow by leaps and bounds," Conrad says. "This is pretty big."

2011



Sensor Technology

San Francisco will become the first major city to use sensors in the road that alter meter prices depending on how many spaces are open. The goal is to nudge people to park in less congested areas. Smartphone apps will display where spaces are vacant. "It's managing the flow of cars," notes Conrad.

OPPOSITE PAGE FROM TOP: NED DISHMAN/GETTY IMAGES; CASEY KELBAUGH/THE NEW YORK TIMES; THIS PAGE: FIRST METER: TIME LIFE PICTURES/GETTY IMAGES; CASHLESS METER: EMILY ANNE EPSTEIN/CORBIS

Etc. Travel

Fantasy Island Smackdown

The battle for the world's most outrageously luxe vacation resort

The resort concept dates to the Roman Empire, when private baths were a customary retreat for the well-off seeking some R&R. Today, international resort destinations are all about fabulously lavish extras. According to January's Orbitz Insider Index, which forecasts travel trends, consumers are interested in hotels with amenities that go well beyond the basics. In resort-speak, this means it's no longer enough to have on-call butlers or a private infinity pool in your overwater bungalow. Such comforts are already ubiquitous among island getaways. To truly have an edge, a resort must up the luxury ante: Think flower petals sprinkled throughout your villa at turndown or an extensive menu–of pillows.

A TripAdvisor survey from last March found that 69 percent of travelers claim the beach is their preferred destination. To appeal to the wealthier strata of this demographic in an uncertain economy, the resort business is currently engaged in a veritable arms race over über-amenities. Who can fly in the freshest Kobe beef, carve their bathtubs out of granite slabs, and offer the most au courant yoga classes?

Herewith, a battle of the world's most spectacularly outrageous, exotically perk-laden island escapes, ranging from old-school favorites to ambitious newcomers. Contestants have been divided by region–the Pacific and Indian Oceans and the Caribbean and Mediterranean Seas–and compete on the basis of their most over-the-top offerings. **B**

—*Alexis Brunswick*



Perivolas's rooms are decorated with island antiques

CONTESTANTS

PACIFIC OCEAN



The St. Regis sprinkles flower petals in villas at turndown

St. Regis Bora Bora
French Polynesia
Renovated in 2010; 91 villas; from $1,435/night

Laucala Island
Fiji
Opened in 2008; 25 villas; from $3,800/night

Le Taha'a
French Polynesia
Renovated in 2007; 60 suites and villas; from $945/night

Four Seasons Costa Rica
Costa Rica
Opened in 2004; 155 rooms; from $595/night

CARIBBEAN

Hôtel Le Toiny
St. Barths
Renovated in 2008; 15 rooms; from $1,700/night

Cap Juluca
Anguilla
Renovated in 2009; 95 rooms; from $995/night

Viceroy Anguilla
Anguilla
Opened in 2009; 166 rooms; from $895/night

Parrot Cay
Turks & Caicos
Renovated in 2010; 70 rooms and villas; from $935/night

INDIAN OCEAN

One&Only Reethi Rah
Maldives
Opened in 2005; 130 villas; from $1,220/night

Banyan Tree
Seychelles
Opened in 2002; 60 villas; from $1,440/night

Le Touessrok
Mauritius
Renovated in 2003; 203 rooms and villas; from $1,230/night

Alila Villas Uluwatu
Bali
Opened in 2009; 61 villas; from $750/night

MEDITERRANEAN

J.K. Place
Capri
Opened in 2007; 22 rooms; from $950/night

Perivolas
Santorini
Renovated in 2010; 20 rooms; from $710/night

Elounda Gulf Villas & Suites
Crete
Opened in 2000; 18 villas; from $1,325/night

La Réserve Ramatuelle
Near St. Tropez
Opened in 2009; 24 rooms; from $950/night



Laucala Island
The St. Regis's butlers, available at any hour, can arrange for guests to explore a private island for a day. Laucala is a private island.



Four Seasons Costa Rica
Le Taha'a's restaurants are built atop indigenous aito trees. The Four Seasons' Casa del Mar estate takes foodie matters one step further: en suite Viking appliances.



Cap Juluca
Individual masks, fins, and snorkels are provided in the Le Toiny villas. Cap Juluca can secure a helicopter or a jet for excursions.



Parrot Cay
Personal chefs cater meals for Viceroy Anguilla guests. At Parrot Cay, however, a private consultant can personalize stress-management programs.



One&Only Reethi Rah
Guests can arrive at Banyan Tree via helicopter. At One&Only, choice cuts of Kobe beef and toro are flown in regularly from Japan.

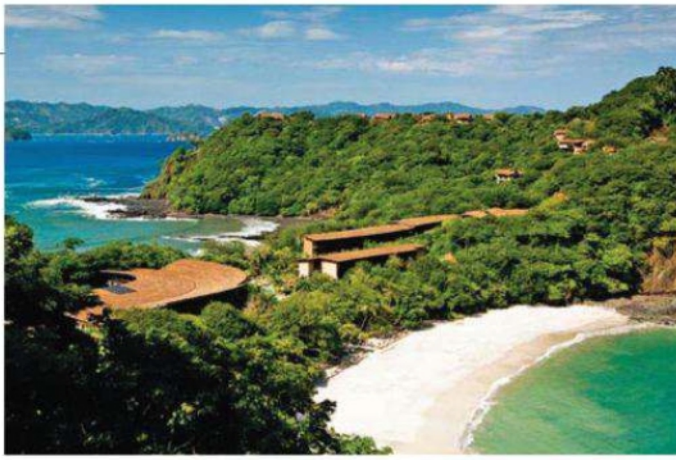
Alila Villas Uluwatu
Le Touessrok's outdoor waterfall showers have nothing on Alila Villas Uluwatu's washing machines and baths, whose excess water is filtered for garden use.



Perivolas
J.K. Place's pool deck overlooks the Mediterranean. At Perivolas, though, the edge of the cliffside infinity pool was designed to appear to merge into the Aegean.

La Réserve Ramatuelle
Elounda's spa villas have private gyms. La Réserve Ramatuelle can design a weight-loss program for guests–including workouts supervised by a personal coach.





Four Seasons guests can volunteer in the local community





One&Only has a private, island-long jogging path

Yoga mats are free on request at Parrot Cay



Laucala Island
The Four Seasons' golf course was designed by Arnold Palmer; Laucala's by David McLay Kidd. Tiebreaker: At Laucala, the entire island is accessible by golf cart.

Parrot Cay
Free cold towels, Fiji water, and sorbet at Cap Juluca's beach don't beat Parrot Cay's complimentary yoga and Pilates classes and fully loaded Kindles.





Laucala Island
Parrot Cay offers a raw food menu. Laucala raises livestock on its organic farm–and provides guests with juices squeezed from fruit grown on the island.

One&Only Reethi Rah
At Alila Villas Uluwatu, flat roofs are insulated with local volcanic rock. At One&Only, flat pillows can be replaced by choices from a pillow menu.



One&Only Reethi Rah
La Réserve Ramatuelle can arrange a yacht rental for tooling around nearby St. Tropez, but the One&Only has its own 55-footer for cruising the Indian Ocean.

La Réserve Ramatuelle
Perivolas's largest suite has an in-room hydrotherapy massage pool. La Réserve Ramatuelle's indoor pool has a counter-current swimming lane.

CHAMPION

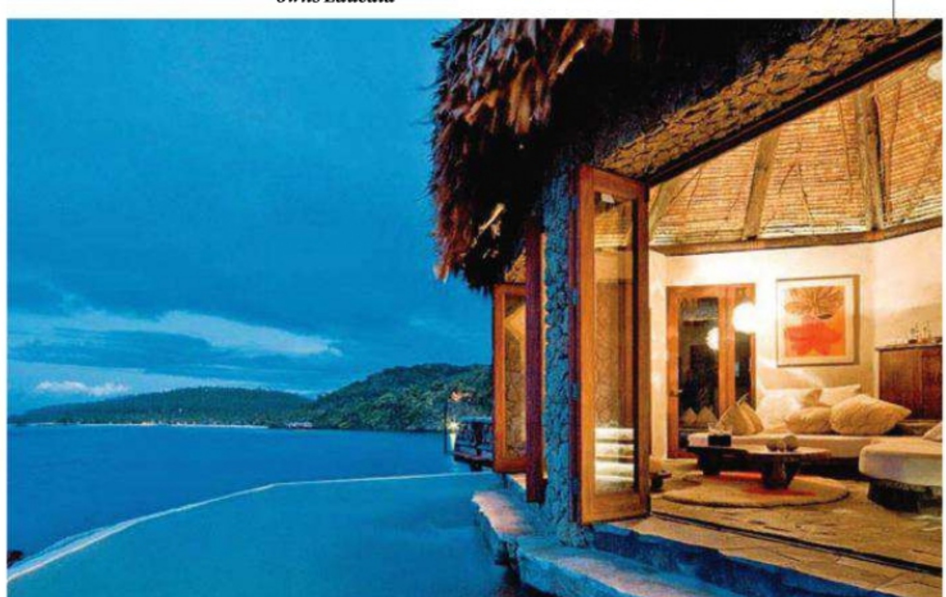
Laucala Island
More than half of One&Only's Reethi Rah island is man-made (15,000 of its coconut trees were imported). But Laucala, which was once a bona fide coconut plantation, is tricked out au naturel: The resort's bathtubs are carved out of granite, and lamp-shades are made of butterfly cocoons. The island's swimming lagoon is one luxurious man-made exception.

Red Bull billionaire Dietrich Mateschitz owns Laucala

La Réserve Ramatuelle's spa uses La Mer products



BLACK AND WHITE PHOTOS: GETTY IMAGES (10)



Moscow's fashion boutiques are helping the wealthy move beyond "the Italian Plague"







Cara&Co's owner has her customer pinned: "He has a trophy wife, and he wants her to have a trophy bag"

The Fashion Politburo

Russian "concept" boutiques help aspiring oligarchs dress like rich bohos. *By Peter Savodnik*

At the 3.14 Project, one of Moscow's newest and most exclusive "concept stores," the typical customer is in his mid-30s and rich. He has a mullet, bad taste, and a man crush on Vladimir Putin. Owner Alexander Moisyenkov's job is to transform these consumers—who favor glittery Armani suits, Versace jeans, Dolce & Gabbana sunglasses, and an extra splash of Acqua di Parma—into modern fashionistos. "He can buy the new Mercedes," Moisyenkov explains, "but we want him to drive the vintage Porsche."

To ease this transition, Moisyenkov has created an intimate store that offers nouveau riche shoppers "a new luxury," as he calls it. "That is the concept of this concept store: the atmosphere," he says. "Here you are losing yourself in the time." His store's name refers to the Greek number pi, "because it goes on forever and ever."

In the past year, Moscow has witnessed a mini-explosion of high-end fashion boutiques that specialize in all manner of "concepts." These stores—whose conceits range from "modern woman" to "*biznesman*" and "Lower East Side" to "hooker-chic"—offer alternatives to big-name luxury labels. In the past decade, brands such as Fendi and Gucci have headlocked the wealthy Russian fashion scene to such a degree that boutique owners refer to the phenomenon as "the Italian Plague." By contrast, concept stores carry lesser-known, super-pricey designers—such as Sweden's Acne Studios and Australia's Akira Isogawa—that adhere to some amorphous concept. They tend to be owned by power divorcées and ex-models married to "minigarchs." Some are even run by people like Moisyenkov, entrepreneurs who know something about fashion and Russian consumption habits.

"If we sell something with gold, we don't call it gold. We call it yellow metal," says one concept store owner

Among the best known are Mood Swings (concept: *femme fatale*), Kuznetsky Most 20 (sugar daddy), Rehab Shop (Courtney Love), and Twins S.h.o.p.p. (indie rock). Cara&Co (Lights! Camera! Action!), which opened in 2007, has become famous among local designers and fashion bloggers, and owner Rosa Alpert is planning a second location in Sydney. LeForm, the only concept store that's too cool to have a concept, has been around since 1997—before the concept of concept stores existed. Owner Rodion Mamontov says that so many people crave the gritty-chic look today that "Dolce & Gabbana doesn't look like Dolce & Gabbana anymore."

No matter their specific concept, these boutiques

PHOTOGRAPHS BY ANNA SKLADMANN FOR BLOOMBERG BUSINESSWEEK



Kuznetsky Most's concept is "sugar daddy" ...



... and the store has turned racing bicycles into a must-have fashion accessory



A shopper scans the racks on the main floor of 3.14 Project

specialize in fashion-forward and muted—but still expensive—pieces. They also rely on a particular brand of aspiring oligarch logic. Instead of flying to London or New York to buy a pair of Rupert Sanderson suede heels for $600 or a Tim Van Steenbergen sheepskin jacket for $1,800, shoppers can stay in Russia and impress fellow poseurs by spending as much as 50 percent more for a look that would work in any major metropolis.

And that's the point. For the past few years, the Kremlin has tried to project an image of normalcy. Russia belongs to the G8, has been chosen to host the 2014 Winter Olympics and 2018 World Cup, and brokers nuclear arms deals with Washington. Many concept store owners feel they're acting in line with the Kremlin's wishes by helping the superrich look shabby—just as they do in Los Angeles. According to James R. Fenkner, a senior analyst at Moscow-based Red Star Asset Management, "Designers and retailers are taking their cue from the Kremlin's strong-Russia theme. All businesses in Russia must pay attention to the Kremlin's wishes."

LeForm's Mamontov says he had to lean on his family to raise the nearly $600,000 to open his first boutique in the late 1990s. After its success, he had no trouble raising capital for his second store, in 2007. "This is how people are dressing now," says Mamontov. Perhaps as a result, neither he nor his investors have run into trouble with the government. Nina L. Khrushcheva, former Soviet Premier Nikita Khrushchev's great-granddaughter and a professor of international affairs at New York's New School, explains that Russia expects the private sector to follow its lead. "Everything in Russia is political, as is the case in most autocratic countries," she says. "The way literature was in the U.S.S.R., so it is now with fashion or concept stores."

"Russian girls are open to everything since traditions have been destroyed so many times"

While concept stores may project the right aura, it's unclear how many consumers can actually afford them. Most store owners say they have only 200 to 300 reliable customers—those who have received VIP cards with discounts of up to 30 percent. Mamontov estimates his stores average 90 customers and $10,000 in sales per day. Says Georgiy Kostava, a 3.14 Project spokesman: "You cannot expect traffic in a place like this. It's a different way of consumption." As any night at Moscow's Vogue Café makes abundantly clear, rhinestones, sequins, and flashy things with lots of zippers remain very much in fashion.

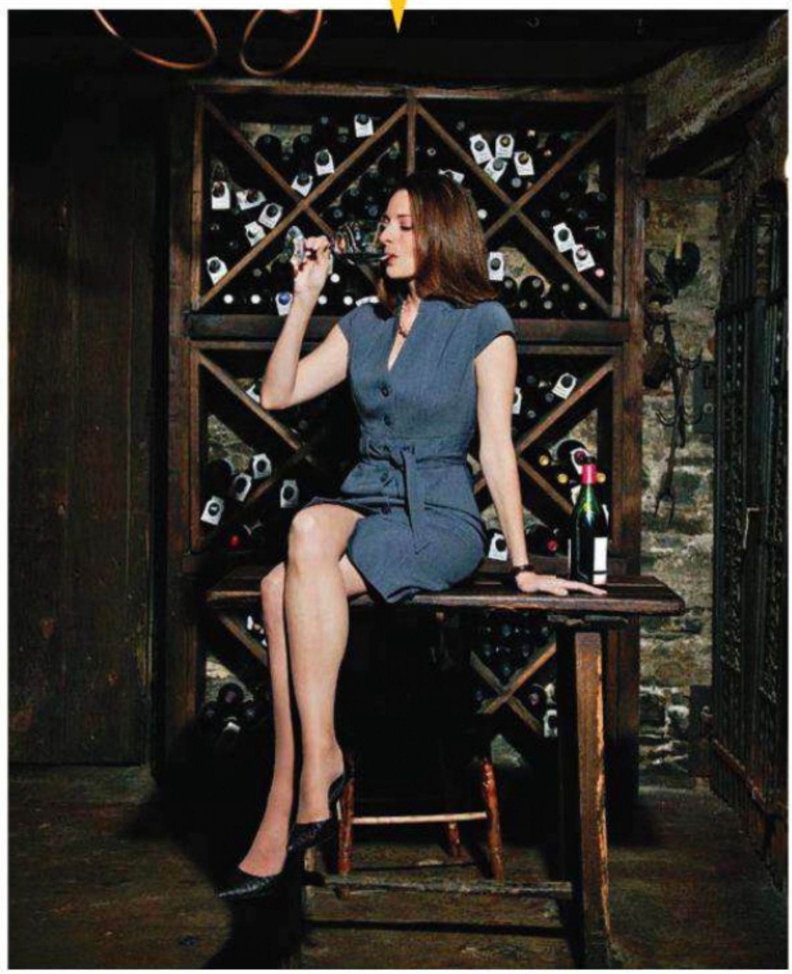
Here lies the challenge of the concept store's long-term viability: its very concept. While the stereotype of the 1990s oligarch—Adidas tracksuit, gaggle of Uzi-wielding bodyguards, and abundant prostitutes—has evolved (oligarchs no longer wear tracksuits), the need to display wealth has not. "These men have short-d--k syndrome," says Cara&Co's Alpert. "He has a trophy wife, and he wants her to have a trophy bag." If that trophy wife comes home with a pair of Henry Cuir sheepskin heels—they run $760 at Cara&Co—her husband might ask why they're not from Gucci, Alpert explains.

Some owners are maneuvering around the issue of subtlety through unsubtle price gouging. "If we sell something with gold," says LeForm's Mamontov, "we don't call it gold. We call it yellow metal. If we sell something with diamonds, we call them transparent stones. With the price, people can understand." Alas, laments Alpert, "What we need are more foreigners and gays. That would be so great. *These* people have fashion sense." Although a new breed of homegrown fashionistas may soon emerge. "Russian girls are open to everything since traditions have been destroyed so many times in the 20th century," says Moscow fashion blogger Vlasta Sofia Guryeva. "They learn very fast."

A few concept stores have tapped into something all Russian consumers crave: exclusivity. Moisyenkov understands this better than most. Amid 3.14 Project's high ceilings, exposed brick, and glowing chandelier, he leads a visitor to a special place—underground. "We call it our 'between friends' room," he says. Moisyenkov descends a hardwood staircase to a "secret door," camouflaged by wood paneling, that requires a "secret key." Inside is a couch opposite a rack of clothes. "Sometimes we take customers downstairs, and I say, 'In there is a secret room, but you cannot see it. If you come back, next time, we will let you in.'" He laughs. "This works. Really, it does." Ⓑ

Natural-Born Swiller

Simonetti-Bryan has built a business—from books to private counseling—through her wine expertise



A nose for business led Jennifer Simonetti-Bryan to a new career in wine. *By Alexandra Wolfe*

A boozy lunch changed Jennifer Simonetti-Bryan's career—in a good way. Entertaining clients in London in 1999, the then-26-year-old Citigroup automotive analyst became fixated by how the acidity of her Sancerre balanced out her fatty salmon entrée. "I kept interrupting people, saying, 'Taste this!'" she says. For her, it definitely beat discussing capital structures.

After that fateful lunch, Simonetti-Bryan started taking wine classes. When Citi transferred her to New York later that year, she enrolled in the Windows on the World Wine School. After the program ended, she left banking and took a job at New York merchant Burgundy Wine Co. for a third of her former salary. "My family thought I'd completely lost my mind," she says. "But I was selling to corporations for executive dining rooms and couldn't imagine anything better." She worked for another wine company before ending up as an educator at liquor stalwart Rémy Cointreau.

Meanwhile, Simonetti-Bryan was pursuing what *The New York Times* has called "wine geekdom's biggest prize": a Master of Wine qualification. The four-day exam, which includes three blind 12-wine tastings, tests a person's understanding of the science and business of wine. She prepared for six years by studying from 5:30 a.m. to 8:30 a.m. before work and again from 7:30 p.m. to 10:30 p.m. In 2008 she became the fourth American female Master of Wine. A year later the Teaching Co., which produces *The Great Courses* DVDs, called. They had noticed her in media appearances and thought she could do instructional wine videos for them. Simonetti-Bryan auditioned and got the nod.

In early 2010 she left Rémy Cointreau to concentrate on building her personal brand. In addition to her instructional DVDs, Simonetti-Bryan, now 37, is writing two wine books. Including fees for consulting services—she advises clients on everything from starting a private collection to opening a wine bar—she makes more than $100,000 a year. "The Master of Wine is very much about understanding the business of wine," says Michelle DeFeo, a Rémy Cointreau vice-president. "Jennifer was a de facto industry analyst"—with a very good nose. Ⓑ

Simonetti-Bryan tasted 10,000 wines when training for the Master of Wine exam



WISHFUL DRINKING

$30,000 Salary at Burgundy Wine, her first job in the industry; she made $90,000 at Citigroup	**$40,000** Cost to achieve Master of Wine title (enrollment, publications, books, wine)
7,000 Number of her instructional DVDs sold in the first month they were offered	**30** Wine regions visited around the world; her favorite wine is white Burgundy

DATA: JENNIFER SIMONETTI-BRYAN

FROM TOP: PHOTOGRAPH BY ERIN PATRICE O'BRIEN FOR BLOOMBERG BUSINESSWEEK; CHARLIE DREVSTAM/GETTY IMAGES; PHOTOGRAPHED AT IL BUCO

Etc. Hands On

Rocky Mountain High Tech

This season's coolest snow gizmos and gadgets

Gloves



Arc'teryx Alpha SV

Complete with a three-layer, waterproof outer shell, these backcountry-ready mitts leave your fingers so nimble that you can pick up a penny. If Darth Vader skied, he'd wear these. *$275, arcteryx.com*

Helmet



Smith Vantage Audio

This brain bucket has a Bluetooth-enabled Skullcandy headset for listening to your black diamond mix or calling friends stuck at the office to rub it in that you're on the mountain. *$340, smithoptics.com*

Vest



Klymit Kinetic Double Diamond

Micromanage your own climate control by pumping up the form-fitting vest with argon gas for insulation. Too warm? Twist a dial to deflate and cool off. Extra gas canisters sold separately. *$225, klymit.com*

Tracker



ShadowBox

Mount this "black box" to your board to record flight data like jump height, hang time, degree of rotation, and spin rate. Upload the data via a USB port to review your ride path in 3D. *$500, shadowboxlive.com*

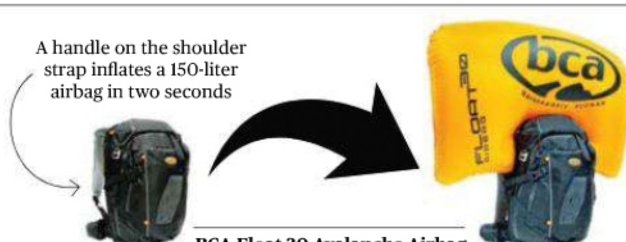
Goggles



Zeal Transcend GPS SPPX

A tiny screen embedded in the polarized and light-adjusting lens displays GPS metrics such as location, speed, and distance traveled. Just don't toggle through the figures mid tree run. *$499, zealoptics.com*

Pack



BCA Float 30 Avalanche Airbag

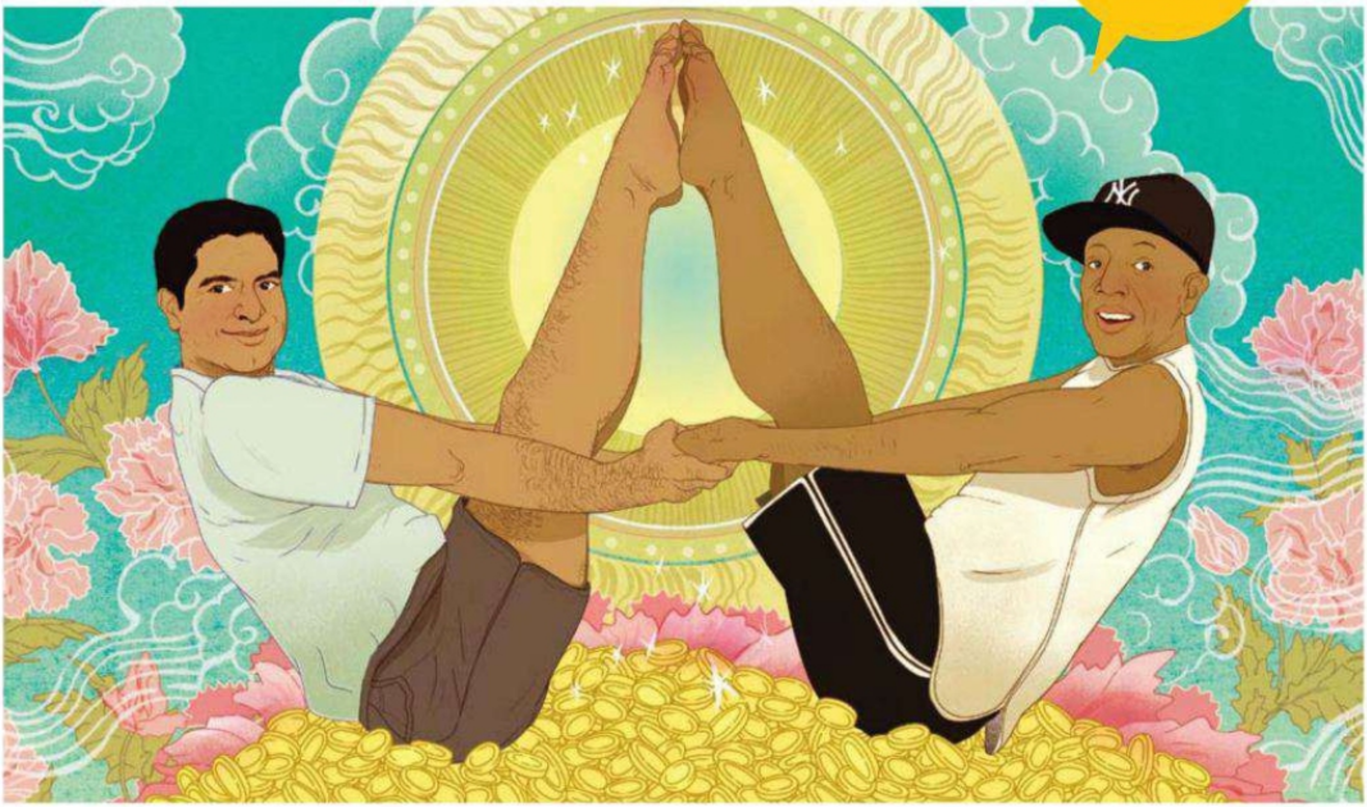
The airbag will help keep you on top of a snow slide rather than buried under it. It protects a skier's head and neck, and can be reused multiple times. The backpack also comes with a shovel. *$700, backcountryaccess.com*

—Steve Mazzucchi



ILLUSTRATION BY LOTTA NIEMINEN

Chopra and Simmons are unhindered by Eastern mysticism's rejection of material pleasures



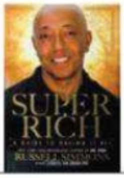
Bling and Nothingness

Two spiritual journeys to business success, big bucks, and eternal happiness. *By Ian McGugan*

It takes nerve to charge readers $22.50 for a book that lectures them about why they should give away their work for free. It takes even more nerve to write a book about why money doesn't matter and call it *Super Rich: A Guide to Having It All*.

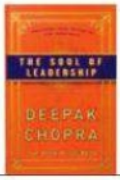
Yes, Russell Simmons has moxie. Give him his due, though: He also has his finger on the pulse. He made his first fortune with Def Jam, a record label that did the seemingly impossible—sell rap acts to a white suburban audience. Then he started Phat Farm, a clothing line that brought inner city style to the hinterland. Later he branched into the movie business, even producing a remake of *The Nutty Professor* with a largely African American cast.

As Simmons edges into his mid-fifties, he's on to the Next Big Thing: enlightenment. To be more specific, enlightenment without those pesky restrictions on greed and ego. Call it Buddhism for the boardroom.



Super Rich: A Guide to Having It All

By Russell Simmons with Chris Morrow
GOTHAM BOOKS
197 pp; $22.50



The Soul of Leadership: Unlocking Your Potential for Greatness

By Deepak Chopra
HARMONY BOOKS
220 pp; $19.99

It's no accident that the endorsement adorning the jacket of *Super Rich* comes from spiritual baron Deepak Chopra, who has been working similar territory for what seems like several lifetimes. (Who knows? If you accept the Buddhist worldview, perhaps he has been.) Chopra's latest work in the great wheel of being, *The Soul of Leadership,* is itself positioned in the enlightened management genre. It's his 60th book. While Judaism, Christianity, and Islam can contain their major insights in a single volume each, Chopra needs an entire shelf.

Unfortunately, he has yet to address the greatest riddle of them all—why anyone should think that Eastern mysticism will lead to material success. At the heart of yoga, Buddhism, and similar traditions—all previous Chopra topics—is the notion that worldly goods don't matter. But let's not nitpick. In deference to Buddha, who was, after all, something of a spiritual entrepreneur, let's explore some of the noble truths revealed in these business texts:

I. Success is elusive. In both authors' works, it's difficult to find concrete business lessons. And perhaps that's the point. For example, writes Chopra: "Your body is a constant projection of you in the world. Every cell eavesdrops on your thoughts."

ILLUSTRATION BY MARCOS CHIN

The author views our metabolisms as chat rooms, with epidermal cells listening in to what's going on in the cranium. If you don't understand what he means, your foot can explain it to you.

II. Be. And just keep being... While Chopra encourages leaders to "be here in the present," Simmons says to "approach all of your work with a smile." According to the authors, the promises that follow are worth it. Simmons assures us that "within a few years you will be able to transform from the unpaid intern into the multimillionaire CEO." Chopra vows that those who lead from the soul will gain the support of invisible powers and can expect miracles to happen—a useful strategy for any executive.

III. Work for free, seek enlightenment, bling it up. Simmons insists the first priority in life is to move toward enlightenment. Why? "Because the road to enlightenment is paved with gold!" According to *Super Rich*, if you attain a holy state, oodles of money will soon follow. Somewhat mystifyingly, Simmons also argues that people should work without expecting payback. He extols yoga, preaches veganism, and gushes over Transcendental Meditation even though he earned his money the old-fashioned way: by working 16-hour days and by promoting groups like South Central Cartel, fonts of deeply spiritual insights such as, "When I let these bullets fly, from this heat, you goin' die."

IV. The pain leads to insight. It's easy to mock Simmons for sprinkling product mentions among his yogic revelations or to snicker at Chopra's pseudoscientific bromides, which would be a lot more effective if he occasionally cited the scientific research he vaguely alludes to. Although anyone who perseveres to the end of both books will be struck with a revelation—we've heard a lot of these tips before. Usually from our mothers. And often before the age of five.

V. Appreciate the wonder. Do readers need Simmons to explain that people don't like being around grouches? Or to be reminded by Chopra that we should take other people's feelings into account? Probably not. Yet many remain eager to be reminded so long as such basics can be linked to making a fortune. Norman Vincent Peale's *The Power of Positive Thinking*, Napoleon Hill's *Think and Grow Rich*, and other enlightened-management tomes have espoused much the same advice for decades. The only thing that changes in these new works is the wrapper. Yoga, hip-hop, and references to cellular biology now dress up the same old pointers on working hard and keeping your chin up. Though give Chopra and Simmons some credit: Their books reawaken a sense of wonder—that such stuff still sells. That's something worth meditating on. **B**

The Soul Moguls

These lifestyle gurus have used the promise of wealth, salvation, or six-pack abs to build their own fortunes. —*Marnie Hanel*

1. Bikram Choudhury
Yoga

The multimillionaire creator of "hot" yoga promises to deliver health and peace through a series of 26 poses practiced in 105-degree heat. "You will not get the intended benefits until it is done 100 percent correct," he says. Of course, it might take a lifetime of pricey classes to get there.

2. Jillian Michaels
Fitness

"Unless you puke, faint, or die, keep going!" So says Michaels, who parlayed a *Biggest Loser* stint into products and services galore: three books, six DVDs, three Nintendo Wii games, two iPhone apps, meal-replacement shakes, kettle bells, free weights, a weight-loss program—and a branded cruise.

3. Rhonda Byrne
Empowerment

The author of *The Secret* took the last decade by storm. Her 2006 paean to positive thinking sold nearly 4 million books in less than six months and, eventually, more than 19 million copies worldwide. In August 2010, Byrne released her long-awaited sequel, *The Power*.



4. Suze Orman
Finance

The personal finance sage's simple advice (pay off credit-card debt! create an emergency fund!) has led to seven *New York Times* best-selling books, an eponymous television show on CNBC, and a *Saturday Night Live* spoof. "Self-worth equals net worth!" says Orman—all the way to the bank.

5. Patti Stanger
Love

Tough love pays off (see *He's Just Not that Into You, The Rules*). Stanger's Bravo show, *Millionaire Matchmaker*, was renewed for a fifth season after 2.2 million viewers watched the January finale. Her DVD, *Married in a Year*, was released this month, though her own engagement fizzled out last year.

6. Joel Osteen
Spirituality

Seven million viewers watch the megachurch pastor's televised services each week. When his Houston congregation outgrew its original building, Osteen moved the church to a 16,000-seat former basketball arena. His 2004 book, *Your Best Life Now*, has sold more than 4 million copies.

CLOCKWISE FROM TOP: K03/ZUMA PRESS/NEWSCOM; NOEL VASQUEZ/FILMMAGIC; MICHAEL CARPENTER/ WENN; FRAZER HARRISON/GETTY IMAGES; GREGG DEGUIRE/PICTUREGROUP/AP PHOTO; NANCY KASZERMAN/ZUMA/CORBIS

Bloomberg Businessweek (USPS 080 900) February 7 – February 13, 2011 (ISSN 0007-7135) T Issue no. 4215. Published weekly, except for a double issue in August and one in December, by Bloomberg L.P. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Executive, Editorial, Circulation, and Advertising Offices: Bloomberg Businessweek, 731 Lexington Avenue, New York, NY 10022. **Postmaster:** Send address changes to Bloomberg Businessweek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 41989020. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com. QST#1008327064. Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001. Copyright 2011 Bloomberg L.P. All rights reserved. Title registered in the U.S. Patent Office. Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com. Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm. Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com. Custom Reprints: For customized bulk reprints of Bloomberg Businessweek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com PRINTED IN THE U.S.A.

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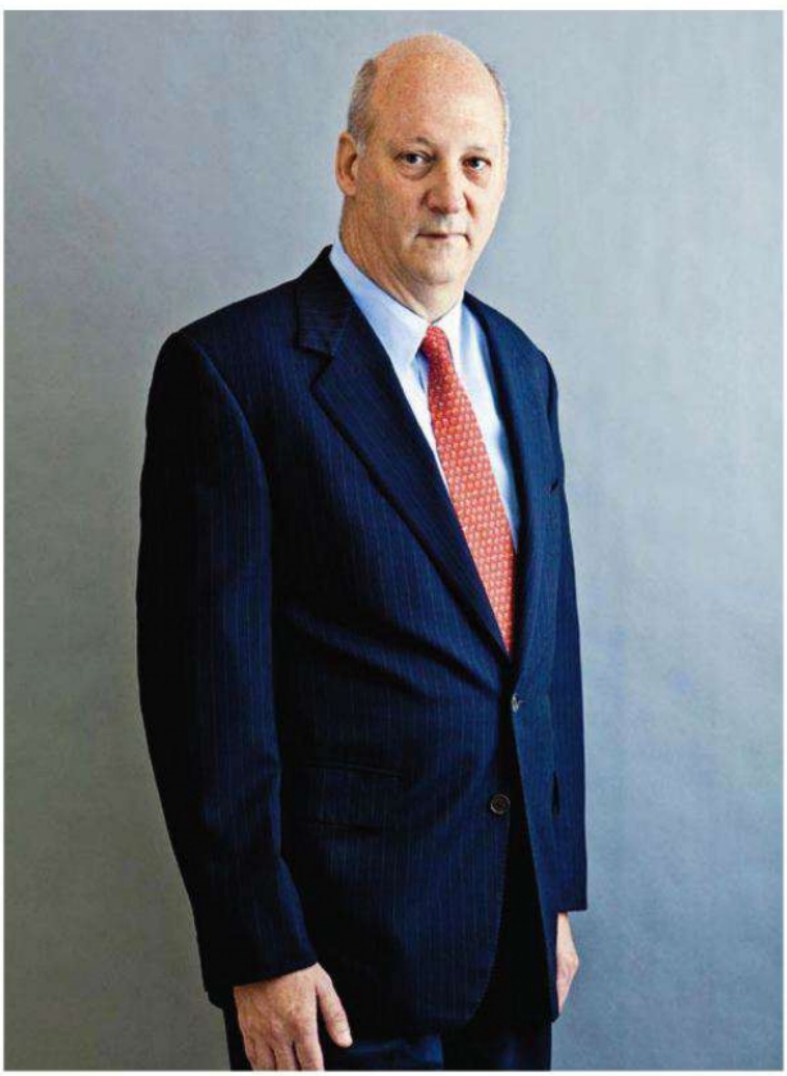
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Etc. Hard Choices

Ronald M. Shaich

"I told my board we had to rip the company apart to focus on Panera. It was a bet-the-job kind of choice.... I was saying double or nothing"

The architect of Au Bon Pain and Panera Bread bakery-cafés on abandoning one business venture to focus on growing another



In 1980, I opened a cookie store in Boston. I wanted to add French baked goods and merged with Au Bon Pain, a small, troubled business that was in debt. I owned 60 percent of the new company. By 1993 we were a public venture with about 250 stores when we bought St. Louis Bread, a chain of cafés that made and served artisan bread. I quickly felt it had more potential than Au Bon Pain. It was tapping into a long-term trend: a drive for specialness. People wanted fresh, local food. We began to roll out bakery-cafés and eventually changed the name to Panera Bread.

Over Christmas in 1998, I was sitting on a beach in the Caribbean and feeling down. Panera was our smallest division, with 135 stores. It was a jewel in the rough, and I felt we were going to screw it up. Then a friend said, "What if Panera owned Au Bon Pain?" I knew I'd have to sell everything and put my energies into Panera. It was a wrenching decision. Au Bon Pain was my first son. But it had to go if Panera was going to be a national brand. I told my board we had to rip the company apart to focus on Panera. It was a bet-the-job kind of choice. There was a big fight, and there was very serious questioning of me. The stock was flat. The Internet was booming and there was pressure to figure out what to do online. I was saying double or nothing.

After getting the go-ahead, our sale to a private equity buyer dragged out over 18 months. I finally threatened to take Au Bon Pain private myself just to get the deal done. We got around $73 million from that to invest in Panera. It wasn't all a success from there. We atrophied after the close and had a drop in profitability. It took a while to evolve the concept. We have about 1,500 Panera cafés now. We're also testing pay-what-you-can cafés as a philanthropic endeavor.

I make my best decisions when I'm on vacation. You're not focused on all the stuff that comes at you as CEO. I've moved into a chairman role and I'm now more productive than ever. My decisions are formed by where I want to go. You can see the sculpture you're trying to make. Then you have to iterate to get there. *—As told to Diane Brady*

PHOTOGRAPH BY TIM GRAY FOR BLOOMBERG BUSINESSWEEK


Opening an IRA is saving.
Vanguarding™ your IRA is saving while saving.
Vanguard your IRA this tax season.
When you invest in a Vanguard IRA®, you're choosing to save on your retirement savings, because we manage our funds at-cost. The funds only cost you what they cost us to run them. So when you're ready to withdraw from your IRA, more of your money is yours.
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